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In the Supreme Court of the United States

OCTOBER TERM, 1936.

No. 539.

THE OHIO BELL TELEPHONE COMPANY,
Appellant,

vs.

THE PUBLIC UTILITIES COMMISSION OF OHIO,
Appellee.

APPEAL FROM THE SUPREME COURT OF OHIO.

APPELLANT'S BRIEF.

KARL E. BURR,
W. H. THOMPSON,
W. B. STEWART,
ASHLEY M. VAN DUZER,
THOMAS V. KOYKKA,
Counsel for Appellant.

CHARLES M. BRACELEN,
Of Counsel.

THE GATES LEGAL PUBLISHING CO., CLEVELAND, OHIO

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Appellee.

APPELLANT'S BRIEF.

NATURE OF CASE.

Appellant, The Ohio Bell Telephone Company, seeks to reverse a judgment of the Supreme Court of Ohio entered against it on July 22, 1936, affirming orders of the Public Utilities Commission of Ohio of January 16, March 1, July 5 and 9, and September 6, 1934.

An application for rehearing (R. 585), seasonably filed, was overruled by that Court October 7, 1936. (R. 7.)

Separate petitions in error were filed by appellant in the Supreme Court of Ohio to review directly in that Court, pursuant to Sections 544 *et seq.* of the General Code, the orders of the Commission referred to. (R. 87, 435, 482, 501.) The petitions in error were consolidated into one case (R. 3; 533), briefed and argued as such, decided in one opinion (R. 533) and by the entry of the one judgment. (R. 7.)

The orders complained of were entered in a company-wide case instituted by the Commission on October 14, 1924 to determine (a) the fair value of appellant's intrastate property and (b) its reasonable rates. (R. 714.)

There were consolidated with the company-wide case 31 pending cases in which increases in the rates for a part

of its service in certain exchanges and in its toll system had been put into effect and were being collected by appellant under statutory bonds. (R. 714.) The Commission's orders fixed values for appellant's property for the years 1925 to 1933, inclusive, required appellant to refund to its exchange subscribers and toll patrons an aggregate amount of $11,832,264 of claimed excess earnings for the years 1925 to 1932, inclusive, found that appellant had had no excess earnings for 1933 and ordered no refunds for that year, but did not fix appellant's rates for the future.

The Supreme Court of Ohio approved the findings and affirmed the orders of the Commission in their entirety. (R. 7; 585.)

OPINIONS IN THE CASE.

None of the Commission's orders is reported, but the opinion and findings accompanying the order of January 16, 1934, with the dissenting opinion of the Chairman, are reported in 2 Public Utilities Reports (N.S.) 113.*

The opinion of the Supreme Court of Ohio is reported in 131 Ohio State Reports, pages 539 to 602, and in 3 N. E. (2d) 475 to 501. (R. 533.)

Appellant's application for rehearing was overruled without opinion.

JURISDICTION.

Pursuant to Rule 12 of this Court, appellant filed a statement showing the grounds upon which it invoked the jurisdiction of this Court under Section 237 of the Judicial Code.

Probable jurisdiction has been noted by this Court.

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* The findings and orders of the Commission complained of are contained in the Record as follows: The findings and order of January 16, 1934 at pages 154 *et seq.*; of March 1, 1934 at pages 273 *et seq.*; of July 5, 1934 at pages 303 *et seq.*; of July 9, 1934 at pages 308 *et seq.* and of September 6, 1934 at pages 372 *et seq.* They are summarized at pages 4 to 12, *infra*. The order of September 6, 1934 is also included in the Appendix hereto, p. xix.

STATEMENT OF THE CASE.

Appellant, a public utility, owns and operates a local and long distance telephone system in Ohio. It was organized September 20, 1921, by the consolidation of the Ohio State Telephone Company and the former Ohio Bell Telephone Company. In the Commission's order approving the consolidation appellant was required to furnish a unified service, combining the services of the two former companies in those cities where the two companies had theretofore furnished competing services. (Company Ex. X-3, R. 6358-9.) The consolidation was the outcome of a widespread demand for the elimination of dual telephone service in Ohio, culminating in a resolution of the Ohio legislature memorializing Congress to legalize such consolidations. (Company Ex. A, R. 6356.)

During the period of the Commission's investigation appellant's rate schedules were of two kinds, (a) schedules of increased rates filed with the Commission, protested, and made effective under separate bonds, limited to the repayment of such portion of the increase as the Commission might find to be excessive, as provided by the Robinson and Pence laws,* and, (b) schedules filed with the Commission, becoming effective without protest or bond, (R. 53; 56; 61-2; 8429-8574) and not subject to refund.

In 1924, when the company-wide case was commenced, there were pending thirty-one separate cases in which increases in appellant's rates for parts of its services in exchanges and in its toll system had thus been made effective under separate bonds. Thereafter additional increases were made effective in like manner. At the time of the Commission's orders forty-six such separate bond cases

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* 108 Ohio Laws 1094 and 110 Ohio Laws 366, since repealed, but with saving clauses. Inasmuch as the two laws are identical in their applicability to the present case, references hereafter to the Pence law (Appendix *infra* p. i) are intended to include both laws.

were pending, all consolidated with the company-wide case. (R. 53-82; 714; 378.)

Each statutory bond provided for the repayment of:

> "such portion of such increased rates • • • as the Commission, upon final hearing, may determine to have been unreasonable or excessive, • • •." (R. 56; 80.)

On October 14, 1924, before the trial of any bond case had been concluded, the Commission on its own motion ordered a company-wide investigation of appellant's property and rates and consolidated the bond cases therewith. The order recited that in all the pending bond cases important issues, common to all of the cases, could best be determined in a single consolidated case. (R. 716.)

Pursuant to Section 499-9 of the General Code, the Commission adopted June 30, 1925, as the "date certain" for the purpose of valuing appellant's property. (R. 126; 166.)

Commission's Orders.

The following is a general description of the Commission's orders:

Order of January 10, 1931
Fixing Tentative Value.

The order of January 10, 1931 (R. 121; 144) was entered after submission of the case upon evidence, briefs and oral argument in behalf of appellant and the state. It fixed the value of appellant's entire property, interstate and intrastate, as of June 30, 1925, the date certain. (R. 145.) This value is commonly referred to as "tentative" because interested parties have the right of protest before it becomes final. Both appellant and the state having filed protests against it, the value did not become final and therefore no petition in error was filed to review it.

Order of January 16, 1934 Fixing Final Value.

In the order of January 16, 1934 (R. 154; 247) the Commission disposed of the protests and determined for each of the years 1925 to 1933 the amount by which appellant's earnings from its entire intrastate business, toll and exchange, exceeded a fair return on the value of its intrastate property. To do this the Commission found for each year, with respect to the intrastate business and property as an entirety:

First, the value of the property.

Second, the fair rate of return.

Third, the dollar amount of such return.

Fourth, the revenues, adjusted expenses (after disallowing large amounts of the expense of depreciation and license contract services) and the resulting net income.

Fifth, the amount by which the resulting net income exceeded the fair return on the property value fixed by the Commission.

By years, the amounts of the excess earnings were found to be as follows:

1925	$1,822,647
1926	2,041,483
1927	1,986,610
1928	1,925,301
1929	1,463,347
1930	1,481,689
1931	1,659,760
1932	908,335
1933	Nothing
Total	$13,289,172

In the order the Commission indicated its intention to require the refund of this entire sum.

Intermediate Orders.

The orders of March 1, July 5, and July 9, 1934 were in the nature of show-cause orders. (R. 273; 303; 308.)

Order of September 6, 1934
Fixing Refunds.

The order of September 6, 1934 (R. 372) was the final order in respect of refunds. Recognizing that a part of the $13,289,172 of excess earnings found in the order of January 16, 1934 was referable to non-bonded rates which, under the law of Ohio, could not be ordered refunded, the Commission in its order of September 6, 1934, by an apportionment designed to exclude the non refundable portion, fixed the amount to be refunded to appellant's exchange subscribers and toll patrons as follows:

	Exchange	Toll
1925	$ 1,137,195	$232,282
1926	1,637,314	176,845
1927	1,823,857	Nothing
1928	1,772,238	"
1929	1,344,624	"
1930	1,357,589	"
1931	1,519,405	"
1932	830,915	"
1933	Nothing	"
Total	$11,423,137	$409,127

The amount ordered refunded for each year was fixed by an apportionment based on gross exchange revenues, as follows: first, by finding the percentage relation of the gross exchange revenues of the exchanges where one or more of the exchange rates were increased under bond (even though in many instances only a few of the rates in such exchanges were bonded), to appellant's total gross exchange revenues for that year; and second, by applying the resulting percentage to the excess earnings from appel-

lant's entire intrastate business found for such year, the resulting amount being ordered refunded to the subscribers whose rates had been increased under bond. (Commission's witness, Wood, R. 3738-57; 3760-76; 3797-3800; Appellant's witness, Brett, R. 3776-96; Wood Exs. 21 and 22 and Wood reports of Aug. 11, 1934; R. 8193-8212.)

Summary of Commission's Findings and Orders.

(1) The Commission's order of January 10, 1931 had tentatively fixed the value of appellant's total property, interstate and intrastate, as of the "date certain" (June 30, 1925) at $104,282,735, of which $101,346,634 represented the intrastate portion on the basis of the separation later adopted by the Commission. (R. 145.)

The Commission's order of January 16, 1934 fixed the final value of the intrastate portion of the property at $93,707,488 as of June 30, 1925. This value was arrived at by eliminating the interstate portion, and by making reductions of $7,860,459 in the tentative value. (R. 196; 247.) The intrastate portions of the reductions, aggregating $7,639,146, were:

$316,090 on account of right-of-way;
$535,970 on account of working capital;
$3,296,181 on account of undistributed construction costs; and
$3,490,905, its previous allowance for going concern value.

(2) The only finding of value based on an inventory and appraisal was that of June 30, 1925.

(3) For each succeeding year, 1926 to 1933, the Commission fixed the final value of appellant's intrastate property by applying a single price trend percentage to the value for the preceding year and then adding the net additions. (R. 187-9; 232.) By this process the Commission fixed values as follows:

1926	$101,767,774	1930	$145,683,047
1927	111,036,522	1931	145,271,663
1928	122,417,735	1932	133,625,655
1929	134,765,576	1933	126,250,206.

(R. 232.)

(4) The trend percentages, related in each year to the value found for the preceding year, were:

1926	98.73% of 1925	1930	95.65% of 1929
1927	96.97% of 1926	1931	93.93% of 1930
1928	99.20% of 1927	1932	88.71% of 1931
1929	101.45% of 1928	1933	102.96% of 1932

(R. 232.)

These percentages, the Commission said, "represent the relation of values for each current period to the preceding period • • •." (R. 232.)

(5) Related to 1925, the trend percentages were:

1926	98.7%	1930	92.2%
1927	95.7%	1931	86.6%
1928	95. %	1932	76.8%
1929	96.3%	1933	79.1%

(R. 245.)

(6) The price trends were based upon information obtained from various sources without appellant's knowledge and not offered or introduced in evidence. With respect to the sources of this information the Commission said:

(a) "A study was made of the cost prices furnished by manufacturers of telephone equipment over the several years";

(b) "The trend of land valuation was ascertained from examination of the tax value in communities where the company had its largest real estate holdings, confining such to urban property only";

(c) "For building trends resort was had to prices (*sic*) indices of the *Engineering News Record*, a recog-

nized magazine in the field of engineering construction";

(d) "Labor trends were developed from the same sources";

(e) "Resort was also had to the finding of the Statutory Court in the Chicago case and its study of price level of sales of the Western Electric Company." (R. 188.)

The record does not otherwise disclose the sources of or any details concerning the price trend information, what weighting was given to the information, how it was compiled, or the method of its application.

Appellant's repeated requests (R. 273; 312; 382-3) to inspect and rebut the information were denied. (R. 275; 373; 722.)

(7) Appellant made a separation of its property, revenues and expenses as between its interstate and intrastate business on the basis of use. (R. 3225-58; 3267-72; Wilson Exs. 1 and 2; R. 8168-9; Brett Ex. 1, R. 6313-6.) The Commission found that appellant's intrastate property was the following percentage of its total property by years:

1925, 97.18448%;	1928, 95.72403%;	1931, 94.44871%;
1926, 96.89229%;	1929, 95.25149%;	1932, 94.63439%;
1927, 96.15796%;	1930, 95.04715%;	1933, 94.63439%.

(R. 243.)

The Commission accepted the separation so made of appellant's property, revenues and expenses. (R. 164.) No question in respect thereof was raised in the Supreme Court of Ohio and it is agreed by the Commission that none will be raised here. (R. 51.)

(8) The final findings of value for 1925, 1926, 1927, and 1928 contained no allowance for parcels of land, purchased as sites for telephone exchange buildings. (R. 160; 233.) The value of these parcels was:

$586,959 for 1925
$550,962 for 1926
$ 95,241 for 1927
$ 53,646 for 1928. (R. 233.)

(9) Except for an increase of approximately 10% effective November 1, 1930, the Commission approved the prices paid by appellant to Western Electric Company for telephone apparatus as fair throughout the period under investigation. (R. 165-9.) The Commission also found that Western's profits in its Bell System business were reasonable. (R. 166; 168.) The Commission's order does not disclose what weighting was given to Western's prices in the trended values of appellant's property for the years 1926 to 1933. It does show that it approved Western's reductions in prices but did not approve the increase referred to. (R. 169.)

(10) The Commission found that at the date certain there was 13.18% of existing depreciation in appellant's intrastate property and accordingly deducted $14,226,709, from its reproduction cost new. (R. 231.) It made no finding on the subject of existing depreciation for 1926 and subsequent years. The depreciated value found for the date certain was trended for the subsequent years with yearly net additions added at cost, undepreciated. (R. 232.)

(11) In respect of the annual expense of depreciation, the Commission found that appellant's retirement losses from September 20, 1921 to June 30, 1925, a period of three years and nine months immediately preceding the date certain, averaged annually 3.74% of the undepreciated cost of appellant's depreciable property. (R. 201-3.) It then stated that for the period under investigation it had allowed a composite annual rate of 4% for that expense. (R. 203.) For the year 1925 it applied the 4% depreciation rate to reproduction cost new less existing deprecia-

tion. For that year, the reproduction cost new (depreciable intrastate property) was $94,964,521. (R. 231; 234; 242.) The allowance for depreciation expense was $3,279,417. (R. 204; 236; 242.) The allowance therefore was only 3.45% of the undepreciated reproduction cost.

It refused to base its allowance for the annual expense of depreciation upon appellant's depreciation rates which appellant proved by classes of plant. (R. 1390-1405; 3212-4; 3216-23; 3640-73; Schneider Exs. 4 to 13 inclusive, and Schneider Ex. 21; R. 7229-39; 7241.) It allowed for this expense for the years 1925 to 1933 inclusive, the period under investigation, $8,067,266 less than appellant's actual intrastate retirement losses during that period. (See table, page 40, *infra.*)

(12) American Telephone and Telegraph Company furnished to appellant and other Bell Associate Companies license contract services for which appellant annually paid a stated percent of its gross revenues for services received by it. Prior to 1926 the percent was 4½. After successive reductions, the payment was fixed on January 1, 1929 at 1½%, where it has since remained. (R. 204.)

The services included assistance and advice in engineering, plant, traffic, operating, commercial, accounting, patent, legal, financial, administrative and other matters relating to appellant's business. (R. 206-7.)

The Commission disallowed a part of the costs incurred in rendering these services. The disallowances were based upon the Commission's finding that the services were either (a) of no benefit to appellant, or (b) incurred by the American Company for its own benefit as a holding company. (R. 211; 210-19.)

Because of such disallowances the Commission deducted from appellant's intrastate operating expenses the following amounts:

1925.....	$732,429	1929.....	$175,773
1926.....	682,004	1930.....	100,906
1927.....	741,006	1931.....	94,350
1928.....	320,448	1932.....	23,302
		Total	$2,870,218

(R. 210-9; 238-41; Appendix hereto, pages xi-xvii.)

(13) It allowed as fair rates of return, 7% for each of the years 1925 to 1929, inclusive; 6½% for 1930 and 1931, and 5½% for 1932 and 1933. (R. 222.)

(14) It found that appellant had excess earnings for each of the years 1925 to 1932, inclusive, aggregating $13,289,172. Of these excess earnings its order of September 6, 1934 required appellant to refund to its exchange subscribers and toll patrons, annual amounts aggregating $11,832,264. (R. 374; 376; 378.) The method by which the excess earnings were fixed and the refundable portion arrived at, is set out at page 6, *supra*.

(15) The Commission found that under its then existing rates, including those increased under bond, appellant had no excess earnings for 1933 and ordered no refunds for that year. (R. 222; 374; 376.)

(16) The Commission's finding of excess earnings for the years 1925 to 1932 was based upon a method which involved the fixing of the value of appellant's entire intrastate property in all of its exchanges and its toll system, as a whole, including exchanges where no increases in rates were collected under bond during the period in controversy. (R. 190.) The Commission, proceeding on this basis, made no finding of property values, revenues, expenses or net income for the exchanges in which increases in rates were collected under bond, either separately or as a group, or for the toll property. It refused to receive proof of such facts offered by appellant. (R. 190; 273; 274; 312; 373; 382; 722; 2944; 2942-5; 2951-2; 8735-6; 8736-8.)

Appellant's Financial Experience.

Under the rates collected, including those increased under bond, appellant had:

(1) A surplus on November 30, 1933, the end of the period under investigation, of $2,813,345 which was nearly $1,000,000 less than the surplus as of June 30, 1925, the first year of the period. (*Infra*, page 78; Wood Ex. 1; R. 8171; 8416.)

(2) Paid dividends on its common stock, from its organization in 1921 to and including 1933, at an average rate of 5.27% per annum. (R. 8364; 8415; 8418; Wood Exs. 1 and 4; R. 8171; 8174.) Appellant's entire capitalization, approved by the Commission, has never exceeded its investment. (Wood Ex. 1; R. 8171; 8361; 8364; 8414; 8415; Uprichard Ex. 4; R. 7397; Eide Ex. 1; R. 6489; 8338.)

(3) A reserve for accrued depreciation which for no year exceeded 12.82% of appellant's total fixed capital or 13.93% of the cost of its intrastate depreciable property. (See table, page 15, *infra*.)

The relation of the reserve to total fixed capital is shown by the following table:

(1) As of June 30	(2) Total Fixed Capital	(3) Reserve for Accrued Depreciation and Amortization of Intangible Capital	(4) Percentage (3 to 2)
1925	$ 98,712,030	$12,560,503	12.72%
1926	108,347,406	12,062,768	11.13
1927	120,846,286	11,808,682	9.77
1928	132,975,578	12,441,734	9.36
1929	145,306,101	14,738,613	10.14
1930	163,560,460	17,377,782	10.62
1931	167,580,606	18,220,463	10.87
1932	171,441,487	20,569,894	12.00
3-31-33	168,740,946	21,627,492	12.82

(Brett Exhibit 6; R. 6332; Eide Exhibits 3 and 4; R. 6531; 6535; and R. 8351.)

In order to show the relation of the reserve to the *intrastate depreciable* property, there has been prepared the following table, which shows for each year, in column (1) the Commission's findings of value; in column (2) the cost of the property plus the Commission's allowance for cash working capital and materials and supplies; in column (3) the cost of the depreciable property; in column (4) appellant's reserve for depreciation resulting from its own accruals; in column (5) the percentage of such reserve to such cost; in column (6) the reserve, recomputed in accordance with the Commission's annual depreciation allowance; in column (7) the percentage of such reserve to such cost, and in column (8) the existing depreciation found by the Commission.

The figures contained in column 1 of the table appear in Appendix B (R. 232) of the Commission's findings of January 16, 1934, Appendix hereto page ix. The finding of existing depreciation, column 8, is found in Appendix A (R. 231) of the Commission's said findings, Appendix hereto page vii. Columns 2, 3, 4 and 6 consist of average figures obtained and compiled from Brett Exhibits 1 and 8, R. 6313; 6333; Eide Exhibit 3, R. 6525; Wood Exhibits 11, 12, 13 and 15, R. 8182; 8183; 8190; finding of January 16, 1934, Appendices B, F and L, R. 232, Appendix hereto p. ix; 236; 243, and R. 8347; 8342; 8352; 8353; 8354; 8355; 8414; 8421; 8425.

	(1) Commission's Value Including Allowance for Working Capital and Supplies	(2) Average Cost plus Commission's Allowance for Working Capital and Supplies
1925	$ 93,707,488	$ 98,798,259
1926	101,767,774	107,424,541
1927	111,036,522	118,526,298
1928	122,417,735	131,597,552
1929	134,765,576	143,380,043
1930	145,683,047	156,319,161
1931	145,271,663	163,153,973
1932	133,625,655	163,723,323
1933	126,250,206	162,403,661

	(3) Average Cost of Depreciable Property	(4) Appellant's Average Reserve for Depreciation at its Rates	(5) Percent of (4) to (3)
1925	$ 87,627,303	$12,156,070	13.87%
1926	96,178,256	12,211,751	12.70
1927	109,503,867	12,049,013	11.00
1928	120,641,748	12,509,865	10.37
1929	128,112,689	13,907,809	10.86
1930	140,909,041	15,812,545	11.22
1931	149,026,163	17,298,870	11.61
1932	149,743,360	19,175,059	12.81
1933	148,320,000	20,655,186	13.93

	(6) Average Reserve Recomputed in Accordance with Commission's Allowance	(7) Percent of (6) to (3)	(8) Commission's Finding of Existing Depreciation
1925	$11,310,960	12.91%	13.18% *
1926	9,615,409	10.00	no finding
1927	7,640,196	6.98	" "
1928	6,212,713	5.15	" "
1929	5,347,981	4.17	" "
1930	4,570,160	3.24	" "
1931	3,259,317	2.19	" "
1932	3,200,905	2.14	" "
1933	3,908,911	2.64	" "

* This figure relates to total intrastate property, depreciable and non-depreciable.

SPECIFICATION OF ASSIGNED ERRORS INTENDED TO BE URGED.

There are fifteen assignments of error. (R. 18.)

All of them support the proposition that the Commission's findings and orders, and the judgment of the Supreme Court of Ohio affirming them, deprive appellant of its property without due process of law and deny it the equal protection of the laws in violation of the Fourteenth Amendment to the Constitution of the United States.

All errors assigned are relied upon except assignments 9 and 10, subdivision (b) of Assignment 12, subdivisions (d) and (e) of Assignment 13, and Assignment 14.* The errors relied on are here summarized in the order in which they will be presented in the argument:

Price Trends. (Argument pp. 25 to 37, *infra.*)

For 1926 to 1933, inclusive, the Commission valued appellant's property solely by the use of price trend percentages, based upon secret information, undisclosed to appellant, not offered or introduced in evidence and which appellant was denied the opportunity to examine or rebut. Upon the valuations so fixed appellant was ordered to refund for those years the sum of $10,462,787 with interest.

These trends the Commission used as a formula of value. It thereby abandoned the exercise of judgment in fixing value, and gave no weight to reproduction cost new. (Assignments of Error 1, 2, 3 and 13(b).)

Expenses. (Argument pp. 37 to 63, *infra.*)

(1) The allowance for the annual expense of depreciation was wholly inadequate. The Commission purported to base the allowance on appellant's retirement experience for the period of three years and nine months immediately pre-

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* The assignments not now relied upon relate to refusal to fix rates for the future, construction work in progress, right-of-way, existing depreciation for 1925, and lack of judicial review.

ceding June 30, 1925, and wholly disregarded appellant's retirement experience during the period under investigation, 1925 to 1933, inclusive. The Commission's allowance was $8,067,266 less than the actual cost of appellant's intrastate plant retirements during that period. The Commission rejected appellant's depreciation rates based on its own experience and established by the undisputed evidence.

(2) For the years 1925 to 1932, inclusive, the Commission erroneously disallowed more than $2,800,000 of appellant's operating expenses representing a part of appellant's annual payments to American Telephone and Telegraph Company for license contract services, needed and used by, and of benefit to, appellant in the operation of its intrastate property. (Assignments of Error 4, 5 and 6.)

Refunds. (Argument pp. 63 to 74, *infra.*)

Under Ohio law, increases in rates not collected under bond are not refundable. The Commission determined the amount of the refunds, not with regard to the value of appellant's property or its net income referable to rates collected under bond, but by the use of accounting apportionments bearing no relation to such value or net income. As a result of such apportionments the Commission in effect required appellant to refund more than $4,000,000 of revenues not collected under bond.

Also, the Commission ordered toll revenues aggregating $409,127 to be refunded for the years 1925 and 1926, without any consideration or finding of the value of appellant's toll property or its toll revenues, expenses or net income and without any factual basis upon which such a refund could have been determined. (Assignments of Error 7 and 8.)

Valuation. (Argument pp. 74 to 86, *infra.*)

The Commission's final valuation of appellant's intrastate property was confiscatory in that:

(1) Seven parcels of useful real estate of the admitted value of more than $500,000 were excluded from the valuation as of June 30, 1925.

(2) No recognition was given to the element of going value. In the tentative finding the Commission found that appellant's property had a going value and made a separate allowance of approximately $3,500,000 therefor as of June 30, 1925. But in the finding of final value it wholly eliminated this allowance and made no other allowance therefor.

(3) Although finding Western Electric prices to appellant for telephone apparatus to have been reasonable during the period when such prices were decreasing, the Commission refused to give any weight to a proper increase therein effective November 1, 1930.

(4) Fair consideration was not given either to the reproduction cost new or the actual cost of the property. (Assignments of Error 11, 12 and 13.)

Overruling Appellant's Protests, Applications for Rehearing and Requests.

Appellant filed with the Commission its protests and applications for rehearing with respect to each of the orders of the Commission complained of. It likewise filed three requests for leave to examine and rebut the undisclosed information on which the Commission's price trend percentages for 1926 to 1933 were based. In each of these protests and applications for rehearing and requests, appellant pointed out specifically the foregoing errors committed by the Commission, asserted that the Commission's action had resulted in a denial of due process, and raised all of the same constitutional questions later presented to the Supreme Court of Ohio and now urged in this Court. (R. 253; 272; 277; 309; 313; 335; 370; 380; 383.) All such protests and applications for rehearing and requests were overruled by the Commission. (R. 274; 275; 372; 373; 719; 722; 724.) (Assignment of Error 15.)

SUMMARY OF ARGUMENT.

USE OF PRICE TRENDS.

Assignments of Error 1, 2, 3 and 13(b);
Argument pages 25 to 37.

In arriving at the value of appellant's intrastate property as of June 30, 1925, the Commission made a detailed appraisal by separate classes of property. In contrast, for the years 1926 to 1933 the Commission fixed the value of the property by applying a single, composite price trend percentage to the property value found for the preceding year, plus net additions, the percentage purporting to reflect the relation of values for the current year to the value for the preceding year.

The values so arrived at for each of the years 1926 to 1932 deprived appellant of its property without due process of law in violation of the Fourteenth Amendment because:

(a) The price trends were based on secret price information obtained from various sources, undisclosed to appellant and not offered or introduced in evidence;

(b) Appellant's written requests to examine and rebut this secret information were denied;

(c) The values were fixed not by the exercise of judgment but by an arbitrary formula which gave no weight to reproduction cost new.

Manifestly, the fixing of a value for each of the years was one of the necessary steps in the Commission's process of determining whether appellant had excess earnings for the year, a portion or all of which appellant could be required to refund. Having found the property value for each year, the Commission then determined the rate of return to which appellant was entitled upon the value thus found and whether its net income for the year as adjusted by the Commission exceeded its permissible earnings. By this method appellant was found to have had excess earn-

ings for each of the years 1925 to 1932, amounting in the aggregate to $13,289,172, of which the sum of $11,832,264 (arrived at by the apportionment method hereafter discussed) was ordered refunded for the years 1925 to 1932. Of the $11,832,264 thus ordered refunded, $10,462,787 represented refunds for the years 1926 to 1932, for which years the property values were determined by the application of the arbitrary formula based on price trend information withheld by the Commission.

DISALLOWANCE OF EXPENSES.

Assignments of Error 4, 5 and 6;
Argument pages 37 to 63.

In finding appellant's net income for each of the years 1925 to 1933 the Commission excluded from appellant's operating expenses large sums on account of (1) the annual expense of depreciation and (2) payments to American Telephone and Telegraph Company for license contract services.

The Commission's action in these respects was arbitrary, unsupported by the evidence and amounted to a denial of due process of law.

(1) Depreciation Expense.

The Commission purported to base its allowance for the annual expense of depreciation upon appellant's retirement experience, that is, the cost of plant retired. It used for that purpose appellant's retirement losses for the three years and nine months immediately preceding June 30, 1925, and wholly disregarded appellant's retirement losses experienced during the years 1925 to 1933, the period for which appellant's rates were under investigation. As the result, the Commission's allowance for the expense of depreciation for the years 1925 to 1933 was $8,067,266 less

than appellant's losses on account of intrastate plant retirements for that period.

The Commission's allowance for the expense of depreciation was also made in disregard of the evidence, which fully established the propriety of appellant's depreciation rates, based on the service life and salvage of its several classes of plant.

It was error to base the amount of appellant's annual depreciation expense upon its retirement experience but if that basis was to be adopted, there was no justification for requiring appellant to absorb without reimbursement more than $8,000,000 of retirement losses experienced during the period under investigation.

(2) License Contract Payments.

Of appellant's total payments to American Telephone and Telegraph Company for 1925 to 1932, inclusive, for license contract services, the Commission disallowed more than $2,800,000 referable to appellant's intrastate business. The disallowances were based upon the Commission's finding that a portion of the services rendered were either (a) of no benefit to appellant, or (b) incurred by the American Company, not in rendering license contract services, but for its own benefit as a holding company. The proof showed that the services were needed, used by, and of benefit to appellant, and that such payments did not exceed the cost to the American Company of rendering the services.

REFUNDS IMPROPERLY ORDERED.

Assignments of Error 7 and 8.—
Argument pages 63 to 74.

During the period covered by the Commission's refund order, increases in some of appellant's rates had been collected under bond, conditioned to repay the portion of the increases found to be excessive. Under Ohio law no refunds could be ordered except with respect to appellant's rates thus collected. Of the excess earnings of $13,289,172 found for the period (1925 to 1932), the Commission ordered refunds to the amount of $11,822,264. This amount was determined arbitrarily, not with regard to the value of appellant's property, or its net income referable to rates collected under bond, but by the use of an accounting apportionment bearing no relation to such value, or net income.

The apportionment undertook to arrive at the amounts of the refunds, first, by finding the percentage relation of the gross exchange revenues of the exchanges where one or more of the rates were increased under bond (even though in many instances only a few of the rates for such exchanges were bonded and subject to refund), to appellant's total gross exchange revenues from all exchanges for that year; and second, by applying the resulting percentage to the excess earnings from appellant's entire intrastate business found for such year, the resulting amount being ordered refunded. The Commission's method was erroneous not only in that it employed gross revenue as the basis for the apportionment, but also in that by counting or treating as bonded revenue all revenue of each exchange wherein any rate was increased under bond, the Commission required appellant to refund more than $4,000,000 of revenues not collected under bond.

Further, the Commission ordered a refund of toll revenues aggregating $409,127 for the years 1925 and 1926

without any consideration or finding of the value of appellant's toll property, its revenues, expenses or net income and without any factual basis upon which such a refund could have been determined.

The method used was purely arbitrary, was arbitrarily applied in disregard of the evidence and resulted in a denial of due process.

VALUATION.

Assignments of Error 11, 12 and 13;
Argument pages 74 to 86.

The Commission's valuation of appellant's intrastate property was confiscatory in the following particulars:

(1) Omitted Land.

On June 30, 1925, appellant owned seven parcels of real estate of an admitted value in excess of $500,000 purchased as sites for telephone exchange buildings. Although on some of the parcels telephone buildings were then under construction and although all of them had been purchased before, and were within a reasonable time after June 30, 1925, actually used in appellant's telephone business, the Commission excluded all of the parcels from the rate base as of that date.

As the result, the final findings of value for 1925, 1926, 1927, and 1928, which contained no allowance for these parcels of land, understated the value of appellant's property by the following amounts:

$586,959 for 1925
$550,962 for 1926
$ 95,241 for 1927
$ 53,646 for 1928

(2) Going Value.

In the finding of tentative value as of June 30, 1925, the Commission made a separate allowance of approximately $3,500,000 for the going value of appellant's property. In the finding of final value the Commission wholly eliminated this allowance and made no other allowance therefor. The existence of going value was established by competent evidence and admitted by the Commission. Failure to give recognition to it either as a separate item or otherwise resulted in a denial of due process.

(3) Western Electric Prices.

The Commission found that the prices charged appellant by Western Electric Company for telephone apparatus were reasonable except for a price increase of approximately 10% effective November 1, 1930. The evidence showed and the Commission found that the profits made by Western in its Bell business were reasonable. The price increase of November 1, 1930 was necessary because Western, after having reduced its prices steadily during the years in controversy, had made a further price reduction in 1929, based upon an expected increase in business which did not develop.

What weighting was given to Western's prices in the Commission's trended property values for the years 1926 to 1933 was not disclosed, but admittedly for those years the Commission gave some weight to decreases in Western's prices and none to the increase of November 1, 1930.

(4) Cost and Reproduction Cost.

The Commission in its valuation failed to give proper weight either to the reproduction cost new or to the actual cost of the property.

ARGUMENT.

I. PRICE TRENDS.

Assignments of Error 1, 2, 3 and 13(b).

The fixing of the value of appellant's intrastate property for each year was one of the necessary steps in the process adopted by the Commission for determining whether appellant had excess earnings for each year, a portion or all of which it could require appellant to refund.

The Commission first determined the value of appellant's property, the rate of return to which it was entitled, and whether its net income, as adjusted by the Commission, exceeded its permissible earnings. By this method it found that appellant had excess earnings for each of the years 1925 to 1932.

The Commission's valuation for 1925 was based upon a detailed inventory and appraisal. In contrast, for each subsequent year the Commission fixed the value of the property exclusively by the use of a composite price trend percentage developed by it and applied to the value found for the preceding year.

The refunds ordered for 1926 to 1932, inclusive, aggregating $10,462,787, with interest, were necessarily based upon the Commission's trended values of appellant's property for those years.

Price Trends Based on Information Withheld from Appellant.

The values so arrived at for 1926 to 1932, inclusive, deprived appellant of its property without due process of law in violation of the Fourteenth Amendment, because the price trends which the Commission applied in fixing such values and which were the basis of its refund order for those years were based on information withheld from appellant and not offered or introduced in evidence.

With respect to the sources of the information upon which its price trends were based the Commission in its findings of January 16, 1934 said:

(a) "A study was made of the cost prices furnished by manufacturers of telephone equipment over the several years";

(b) "The trend of land valuation was ascertained from examination of the tax value in communities where the company had its largest real estate holdings, confining such to urban property only";

(c) "For building trends resort was had to prices indices of the *Engineering News Record*, a recognized magazine in the field of engineering construction";

(d) "Labor trends were developed from the same sources";

(e) "Resort was also had to the finding of the Statutory Court in the Chicago case and its study of price level of sales of the Western Electric Company." • (R. 188.)

Appellant first learned of the Commission's use of price trends in fixing values for the years 1926 and thereafter when the order of January 16, 1934 was announced. (R. 187.) On February 6, 1934 appellant filed its protest and application for a rehearing in which it complained of the Commission's use of the trends and on February 17, 1934 its written request for an opportunity to examine and rebut the information upon which they were based. (R. 256; 273.) This request was followed by two similar ones. (R. 312; 383.) The protest and all three requests were summarily overruled. (R. 274; 275; 373; 722.)

• Appellant was familiar with the findings of the statutory court in respect of Western Electric Company prices for telephone apparatus, but it had no opportunity to ascertain what weighting was given to this information or how the prices were applied by the Commission.

The protest and requests challenged, as a denial of due process, the action of the Commission in withholding from appellant the information on which the price trends were based. At every other appropriate stage of the proceedings, both before the Commission and in the Supreme Court of Ohio, appellant challenged this withholding of information and asserted its constitutional rights in respect thereof, all to no avail. (R. 278-80, 303; 321-2, 324; 336-8, 369-70; 387-9, 431; 94-6, 115; 441-3, 480; 487-9, 499; 506-8, 531; 592-5.)

Thus appellant has been denied all information with respect to:

(a) the names of the manufacturers of the telephone equipment referred to in the findings, the prices furnished by them, the years to which the prices applied, and the nature of the equipment for which the prices were furnished;

(b) what land values were used by the Commission, for what years, and in what cities of Ohio;

(c) what trends were taken from the *Engineering News Record*, and to what character of building, material and labor costs they applied; and

(d) how the trends were compiled and the prices, costs, values and other information weighted.

The only other part of the record which sheds light on the character of the information is the following statement from the dissenting opinion of the chairman of the Commission, accompanying the findings and order of January 16, 1934:

> "These cost trends applied in the majority findings do not reflect telephone construction costs. They were derived from trade magazines and other publications not in evidence, and as to which the telephone company has had no opportunity to be heard." (R. 224.)

This the majority has never denied in any subsequent finding or order.

The record does not otherwise disclose the sources of or any details concerning this price trend information, how it was compiled, or what weight the Commission gave it in fixing the value of appellant's property for the years in question.

Denial of Due Process.

The use of such information in fixing the value of appellant's property for all years subsequent to 1925 was a denial of due process. In effect, there has been no trial.

Interstate Commerce Commission v. Louisville & Nashville Railroad Co., 227 U. S. 88, 57 L. ed. 431;

West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 1) 294 U. S. 63, 79 L. ed. 761;

West v. Chesapeake & Potomac Telephone Co., 295 U. S. 662, 79 L. ed. 1640.

In *Interstate Commerce Commission v. Louisville & Nashville Railroad Co., supra,* this Court in holding that an order of a regulatory body must rest on evidence, said (p. 91):

> "if the Government's contention is correct, it would mean that the Commission had a power possessed by no other officer, administrative body, or tribunal under our Government. It would mean that where rights depended upon facts, the Commission could disregard all rules of evidence, and capriciously make findings by administrative fiat. Such authority, however beneficently exercised in one case, could be injuriously exerted in another; is inconsistent with rational justice, and comes under the Constitution's condemnation of all arbitrary exercise of power. • • •

"All parties must be fully apprised of the evidence submitted or to be considered, and must be given opportunity to cross-examine witnesses, to inspect documents and to offer evidence in explanation or rebuttal. In no other way can a party maintain its rights or make its defense. In no other way can it test the sufficiency of the facts to support the finding; for otherwise, even though it appeared that the order was without evidence, the manifest deficiency could always be explained on the theory that the Commission had before it extraneous, unknown but presumptively sufficient information to support the finding."

In *West Ohio Gas Co. v. Public Utilities Commission of Ohio, supra,* this Court, commenting upon the Ohio Commission's *ex parte* use of the annual reports of the utility whose rates were under investigation, said (p. 69):

"A hearing is not judicial, at least in any adequate sense, unless the evidence can be known. • • •

"But the weakness of the case for the appellee is that the fundamentals of a fair hearing were not conceded to the company. Opportunity did not exist to supplement or explain the annual reports as to the distribution of the expenses in the neighboring communities, nor did opportunity exist to bring the rates outside of Lima into harmony with the exigencies of a new method of allocation adopted without warning."

In the present case the undisclosed information was not from appellant's records. It was compiled, weighted and applied in a way wholly unknown to appellant. It came from sources not sufficiently identified to furnish more than meagre information as to its general, and none as to its specific, character.

The trended value for 1926 and each of the subsequent years was one of the necessary factors in the Commission's determination that appellant was liable to refund $10,462,787 for those years. Appellant has been ordered to re-

pay this sum without any hearing, because the evidence upon which the value of its property was fixed has been withheld from it.

Appellant's Evidence Rejected.

As shown at page 3, *supra*, appellant's rates during the period of the Commission's investigation were of two kinds: (a) those in effect pursuant to the Pence law, under bond limited to the repayment of "such portion of such increased rate" as the Commission might determine to be unreasonable or excessive, and (b) those in effect without bond.

Under the Ohio law refunds could not be ordered with respect to rates not collected under bond:

> *City of Lima v. Public Utilities Commission*, 106 Ohio St. 379, 386, 140 N. E. 147, 149 (1922);
>
> *Great Miami Valley Taxpayers Assn. v. Public Utilities Commission*, 131 Ohio St. 285, 2 N. E. (2d) 777 (June, 1936).

This principle was recognized in the present case by the Commission in its findings and by the Ohio Supreme Court in its decision. (R. 304; 372; 3738-57; 3797-3800; 244; 276; 8193-8212; 534.)

Appellant repeatedly offered to prove that the Pence Law rates made effective under bond were reasonable, by showing the fair value of its property and its net income in the affected exchanges and the toll system. (See page 12, *supra*.)

Indeed the Commission itself concedes that appellant insisted, throughout the progress of the proceeding, upon its right to make such proof, saying, in its findings of January 16, 1934:

> "With the institution of the company-wide case, the Commission as then constituted determined not

to proceed at that time with the separate Robinson Law and Pence Law cases, and the Commission's inquiry has ever since proceeded on the company-wide basis, without separate testimony as to the property value, rates, etc., for the Robinson and Pence Law cases. This course originally had and apparently ever since has had the approval of the City Attorneys interested in those cases, although the Telephone Company has always insisted upon the right to present, and has offered to present, separate testimony with respect to them." (R. 190.)

Decision of Supreme Court of Ohio.

That the price-trends used by the Commission were based on information withheld from appellant and to which it was denied access is not disputed. The Supreme Court of Ohio, admitting this, sought to justify the Commission's action solely on the ground that this Court has decided that judicial notice may be taken of the existence of a depression and of the fact that there have been profound changes in value during the progress of a hearing.

In that connection the Supreme Court of Ohio said:

"Likewise the company strenuously complains because, although neither side introduced evidence of price trends, the commission took judicial notice of such trends; but even a casual examination of the decisions of the United States Supreme Court unquestionably discloses definite and repeated sanction of this principle." (R. 570.)

and cited:

Central Kentucky Natural Gas Co. v. Railroad Commission of Kentucky, 290 U. S. 264, 78 L. ed. 307;

Dayton Power & Light Co. v. Public Utilities Commission of Ohio, 292 U. S. 290, 78 L. ed. 1267;

Atchison, Topeka & Santa Fe Railway Co. v. United States, 284 U. S. 248, 76 L. ed. 273.

Although these cases are authority for the proposition that judicial notice will be taken of the fact that there have been profound changes in price levels and economic conditions, they are not authority for the valuation of property by a regulatory body by the use of secret information.

To sustain the Commission's orders, it was necessary for the Ohio court to hold that judicial notice may be taken not only of the existence of a depression, with consequent marked declines in property values, but also of the extent of the declines, and that, having done so, the Commission may then withhold from the utility such information as was used.

If the ruling of the Supreme Court of Ohio in the present case be correct, values for utility property may lawfully be fixed *in camera*. Hearings in such cases would become an idle ceremony. The Commission would be authorized to notice judicially the extent to which changes in economic conditions had affected utility property and to fix values accordingly.

For such action no decision of this Court, either in letter or spirit, affords the slightest justification. The exercise of such arbitrary power is inconsistent with every concept of a fair hearing.

Use and Effect of Valuation Formula.

In order to obtain the value of appellant's property for 1926, the Commission applied a price trend percentage to the value found by it for 1925. The trend percentage for 1926 was 98.73 of the 1925 value. The value for each succeeding year was fixed by an identical process. The trend percentages for the other years are set out at page 8 *supra*.

That the Commission converted the value for each year into a value for the next succeeding year solely by the use of a trend percentage which, when ascertained, was applied without modification, appears from the following statement in its findings:

> "The composite percentages shown on Line 2 were developed by the Commission's Engineers and represent the relation of values for each current period to the preceding period and they have been applied to the basic figures bearing corresponding alphabetical designations."* (R. 232.)

Thus it appears that by the use of the price trends the Commission abandoned the exercise of judgment in fixing value, gave no weight to reproduction cost, and gave full weight to every fluctuation in value found by it to have occurred between 1926 and 1933. That this is true appears from the following portion of the Commission's graph (R. 245) which shows the trends developed and applied by it in fixing the value of appellant's property for each year subsequent to 1925:

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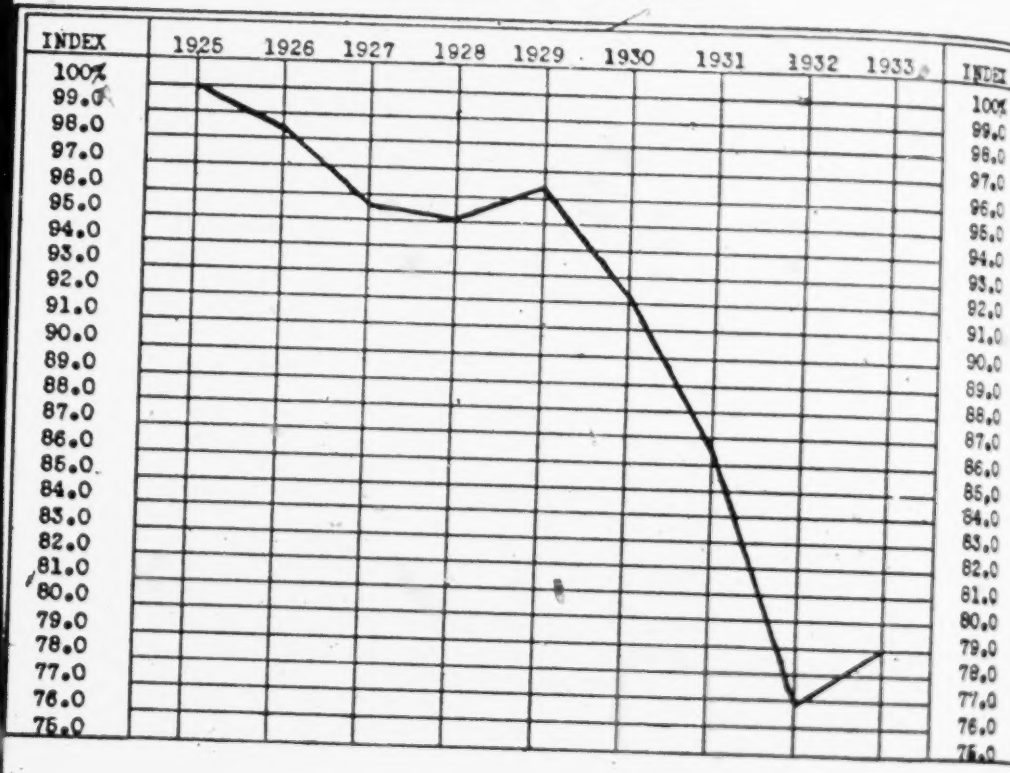
* This quotation appears in the table showing the Commission's application of price trends, Appendix B to the Commission's finding of January 16, 1934, Appendix hereto, p. ix. The basic figures referred to are the values for each preceding year.

COMMISSION'S PRICE TRENDS.



The Commission's use of these price trends, whereby it precluded the exercise of judgment as to value and gave full weight to every price fluctuation found by it to have occurred during the period, resulted in the denial of due process.

West v. Chesapeake & Potomac Telephone Co., 295 U. S. 662, 79 L. ed. 1640.

In that case, this Court, in condemning the use of a price trend formula in fixing values, said (p. 671):

> "To an extent value must be a matter of sound judgment, involving fact data. To substitute for such factors as historical cost and cost of reproduction, a 'translator' of dollar value obtained by the use of price trend indices, serves only to confuse the problem and to increase its difficulty, and may well lead to results anything but accurate and fair. This is not to suggest that price trends are to be disregarded; quite the contrary is true. And evidence of such trends is to be considered with all other relevant factors."

In the same case this Court held that although the owner of utility property is entitled to the benefit of an enhancement in value when a permanently higher price level has been reached and must suffer the loss incident to a permanently lower price level, the character of utility property is such that its fair value does not shift with each temporary price change. The Court said (p. 672):

> "But it is to be remembered that such a property as that here under consideration is a great integrated aggregate of many and diverse elements; is not primarily intended for sale in the market, but for devotion to the public use now and for the indefinite future; and has, so far as its market value is concerned, no real resemblance to a bushel of wheat or a ton of iron. While, therefore, the owner of such a property must assume and may not pass on to the public the risk involved in a general decline in values, and may

have the advantage also of a general rise in such values, it would not only be unfair but impracticable to adjust the value and the consequent rate of return to sudden fluctuations in the price level. For in its essence this is the sort of aggregate whose value is not fairly or accurately reflected by such abrupt alterations in the market. A public service corporation ought not, therefore, in a rate proceeding, to be permitted to claim to the last dollar an increased value consequent upon a sudden and precipitate rise in spot prices of material or labor. No more ought the value attributable to its property to be depressed by a similar sudden decline in the price level."

Here, by the use of price trends, the Commission decreased the value of appellant's property between December 31, 1929 and December 31, 1932, from 96.3% of the 1925 base to 76.8% of that base. The effect of the trending was that at the end of the period (1933), the Commission's finding of value was $35,000,000 less than appellant's investment in plant. (R. 232; 8414.)

That the Commission did give full weight, and admittedly so, to each year's fluctuation in the price level is graphically illustrated by the price trend percentages shown in the chart *supra* at page 34, and by the Commission's statement that those percentages "represent the relation of values for each current period to the preceding period." (Finding of January 16, 1934, R. 232; Appendix hereto, page ix.) That the fluctuations reflected by the Commission's price trends were abnormal is illustrated by the almost precipitous decline beginning with 1929, the first year of the depression, and ending with the year 1932, the Commission's level for the latter year being 20% below the 1929 level and 23% below the 1925 level. Not only that, but the chart shows that by 1933 prices were again sharply in the ascendance, clearly demonstrating that none of the decline between 1929 and 1932 reflected a new permanently

low level of prices. As already stated, appellant does not know what prices or other factors the Commission used in formulating its trends, how they were weighted or how applied. With respect to the results of their application, however, the Commission's chart tells its own story. Trended values, arrived at no one knows how, but reflecting on their face sudden, even violent, fluctuations in price levels are unfair in themselves, quite apart from the method employed in arriving at them.

II. DISALLOWANCE OF EXPENSES.

Assignments of Error 4, 5, and 6.

The Commission overstated appellant's net income by excluding large sums from its operating expenses for each of the years 1925 to 1933 on account of (1) the annual expense of depreciation and (2) payments to American Telephone and Telegraph Company for license contract services.

(1) Annual Expense of Depreciation.

The Commission purported to base its allowance of 4% for the annual expense of depreciation upon appellant's retirement experience, that is, the loss resulting to appellant from the retirement of plant. (R. 200-3.) But for this purpose it used solely appellant's retirement losses from September 21, 1921 to June 30, 1925, a period of three years and nine months immediately preceding the date certain. (R. 201-3.) It completely disregarded appellant's proven retirement losses for the years 1925 to 1933, the exact period for which the allowance for the annual expense of depreciation was fixed and allowed for that expense $8,067,266 less than the actual cost of such retirements. (See table, page 40, *infra.*)

Depreciation Rate Calculated on Undepreciated Base But Applied to Depreciated Base.

Before discussing the effect of the Commission's allowance, attention is called to the wholly inconsistent method by which the 4% composite rate was calculated and applied.

After finding that appellant's retirement losses during the earlier period (1921-1925) had averaged annually 3.74% of the undepreciated cost of appellant's property, the Commission stated that it had allowed a composite rate of 4% for the annual expense of depreciation during the period under investigation. (R. 203.) In reality its allowance for 1925 was only 3.45% of the undepreciated reproduction cost.

Since 3.74% was the ratio of actual retirement losses to *undepreciated* cost, if the allowance for the period under investigation was to be even the equivalent of appellant's retirement losses during the earlier period, the Commission was bound to apply the 3.74% to an *undepreciated* base, i.e., to the *undepreciated* reproduction cost of appellant's property. If the allowance was to be the rounded figure of 4%, it was similarly bound to apply the 4% to an *undepreciated* base.

Instead, the Commission applied its 4% depreciation rate to the reproduction cost new *depreciated*, which for the year 1925 was the equivalent of only 3.45% of the *undepreciated* reproduction cost. (R. 203; 204.) For that year, the reproduction cost new of the intrastate depreciable property, as fixed by the Commission, was $94,964,521. (R. 231; 234; 242.) The reproduction cost new, less depreciation, as fixed by the Commission, was $81,956,540. The Commission's allowance for the annual expense of depreciation for that year was $3,279,417. (R. 236.) This allowance was 4% on a depreciated base but only 3.45% on an undepreciated base.

Had the Commission applied the 3.74% (the ratio of retirement losses to book cost 1921-1925) to its value of appellant's depreciable property (undepreciated) for the years 1925 to 1932, its allowance for the annual expense of depreciation would have been $1,404,668 greater than it was. Had it applied the 4% to such value during the same period, its allowance for this expense would have been $4,117,484 greater than it was. (Computed from appendices A, F, L and K to Findings of January 16, 1934, R. 231; 236; 242; 243.)

While clearly an annual rate of depreciation should be applied to an undepreciated, not a depreciated base, that is not the point made here. The point is that the Commission having related the retirement losses for 1921 to 1925 to the undepreciated cost of the depreciable property for that period and thus arrived at a ratio for computing that expense, was bound to apply that ratio to the same sort of a base in the period for which the depreciation rates were fixed.

The Commission had no right to determine appellant's expense of depreciation for the period under investigation by its retirement losses, and particularly not by the retirement losses of an earlier period. But certainly if this method was to be adopted the Commission should at least have calculated this expense fairly.

Depreciation Allowance $8,067,266 Less Than Actual Retirement Cost.

But however the expense of depreciation was calculated, the inescapable fact is that the Commission's allowance for the expense of depreciation for the years 1925 to 1933, inclusive, was $8,067,266 less than the actual cost to appellant of its intrastate plant retirements during that period as shown by the following table:

COMPARISON OF INTRASTATE RETIREMENT COST WITH DEPRECIATION ALLOWANCE.

Year	(1) Retirement Cost	(2) Commission's Depreciation Allowance	(3) Retirement Cost Exceeds Depreciation Allowance (1—2)
1925	$4,087,957	$3,279,417	$ 808,540
1926	6,147,042	3,615,622	2,531,420
1927	5,480,935	4,057,929	1,423,006
1928	6,087,763	4,549,602	1,538,161
1929	5,286,358	4,963,810	322,548
1930	6,863,374	5,488,561	1,374,813
1931*	7,295,279	5,805,198	1,490,081
1932†	4,732,839	5,858,001	‡1,125,162
1933†	5,507,983	5,804,124	‡ 296,141
Total	$51,489,530	$43,422,264	$8,067,266

In the case of a rapidly growing telephone property, such as appellant's, the retirements at one point of time relate to the older and smaller plant, and therefore, the depreciation allowance for such a property should be in excess of a sum merely sufficient to meet current retirement losses. (*Cf. Lindheimer v. Illinois Bell Telephone Co.*, 292 U. S. 151, at p. 171, 78 L. ed. 1182.) It was therefore error for the Commission to have based the allowance for the annual depreciation expense wholly upon appellant's retirement experience, but if that basis was to be adopted, certainly there was no justification for requiring appellant to absorb without reimbursement $8,067,266 of

‡ Indicates red figures.

* Compiled, for 1925 to 1931, from Wood Ex. 12, R. 8182 B, and Finding of Jan. 16, 1934, Appendices F and L, R. 236; 243.

† Based on Monthly Report No. 6 for Month of November, 1933, R. 8424, and Finding of Jan. 16, 1934, Appendices F and L, R. 236; 243.

retirement losses during the exact period for which its rates were under investigation. This is precisely what the Commission's orders accomplish.

In speaking of an analogous situation this Court in *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (No. 2) 294 U. S. 79, 79 L. ed. 773 said (p. 81):

> "The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. To shut one's eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guesswork with evidence available."

Appellant's Annual Depreciation Rates Rejected.

In determining annual rates of depreciation the factors to be considered are service life and net salvage. (R. 1391; 1392; 3212; 6946, 7021-2.) Appellant's annual rates for each of its several classes of plant were based on these factors and the propriety of its rates established by its engineers, familiar with the telephone business in general and with the particular plant under consideration. (R. 1390-1405; 3212-4; 3216-23; 3640-73; Schneider Exs. 4 to 13 inclusive, and Schneider Ex. 21; R. 7229-39; 7241.) These rates were not criticized by Hagenah, the Commission's witness, although he had been asked by the Commission "to report to the Commission the proper depreciation requirement" for appellant, (R. 1984; 2132) and throughout the entire investigation the rates were challenged by no one. The Commission's action in rejecting them was arbitrary.

The Commission rejected appellant's depreciation evidence and in effect adopted the retirement method, although its allowance for the expense was less than appel-

lant's retirement losses experienced during the period in controversy.*

The retirement method of determining the expense of depreciation results in postponing charges for loss currently sustained on account of depreciation until such losses are fully realized and the depreciated plant removed from service. Under this method the utility is not expected to and will not receive reimbursement for the loss of its property until actual removal.

Depreciation accounting, on the contrary, contemplates that losses due to the depreciation in the value of plant are to be charged to operating expenses in equal monthly installments for the period of the service life of the property and that thereby the utility will receive compensation for such loss as it is being occasioned, without respect to whether the plant is then removed from service. (R. 6946, 7021-2; 3220.)

When depreciation accounting is adopted, it is fair that the utility shall earn on the present, i.e., the depreciated, value, because it is currently receiving compensation for loss in respect of plant whose service life is being exhausted but which has not yet been retired from service.

On the contrary, if retirement accounting be adopted no substantial reserve is contemplated and none will in fact be created. For example, in this case, if appellant's reserve for depreciation be recomputed in accordance with the Commission's annual depreciation allowance, its reserve which was $12,156,070 in 1925 would have been reduced to $3,908,911 in 1933. The table showing these amounts appears on page 15 *supra*.

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* Retirement accounting was condemned as unsound by the Interstate Commerce Commission in Docket 14700, "Depreciation Charges of Telephone Companies," 177 I. C. C. 351 at pages 394-5 and so far as appellant knows has never been approved by any court.

Under the retirement method appellant will be reimbursed for loss only when fully realized. In the meantime, if permitted to earn on a depreciated base only, it will have in service at all times property for which it is receiving neither a current return, nor reimbursement for progressive depreciation.

In this case the Commission, in arriving at the rate base as of June 30, 1925, deducted from the value of appellant's property the sum of $14,226,709 on account of existing depreciation and in addition, as we have heretofore shown, limited appellant's depreciation expense to an amount which was less by $8,067,266 than the actual cost of its plant retirements during the period under investigation.

The Commission was right in deducting existing depreciation in arriving at the value of appellant's property. It was wrong in determining the annual expense of depreciation by a method which denied appellant an opportunity to create a reserve for depreciation.

Attempted Justification of Commission's Depreciation Rates.

It is attempted to justify the Commission's allowance for the annual expense of depreciation on the grounds (a) that appellant's retirement experience during the period under investigation, 1925 to 1933, was abnormal, (b) that the Commission gave actual consideration to appellant's retirement experience during these years, (c) that appellant's annual rates of depreciation were fixed at excessive amounts in order to build up reserves for depreciation insufficient at the date of appellant's organization, and (d) that appellant's voluntary reduction in its rates of depreciation for 1932 and 1933 was an admission that its rates prior thereto were excessive.

The record does not sustain any of these claims.

(a) Appellant's retirement losses during the period under investigation were not abnormal. The accounts showing such losses were examined by the Commission's accountant. (R. 3634-5; Wood Ex. 12, R. 8182 B.) They were not challenged as unnecessary in any respect by him (R. 3634-5), by any other witness, or in the Commission's findings.

The claim of "abnormal" retirement losses rests solely upon the assertion that some of appellant's properties acquired from predecessor companies included duplicate, non-useful plant facilities the subsequent removal of which resulted in abnormal plant retirements.

Appellant was organized in 1921 by the consolidation of the Ohio State Telephone Company and the former Ohio Bell Telephone Company. Pursuant to a wide-spread public demand, the competing service furnished by these companies in certain cities in Ohio was eliminated by physical unification of the plants. The unification had been practically completed prior to the date certain (Eide Ex. 1, R. 6492 B.)

In 1926 Hagenah, the Commission's witness, investigated the situation and testified that while there was some duplicate property if by that term was meant "parallel construction," there was no non-useful plant.

In this connection he said:

> "This property to which you have now directed my attention (telephone buildings), as well as the parallel poles, wires and cable construction, was all used and useful on the inventory date with no more excess capacity than is usually regarded as proper for spare facilities." (R. 2098.)

This evidence was never disputed. The Commission decided, as it was bound to do, that appellant had no unnecessary plant margin. It made no deduction from ap-

pellant's property on account of non-useful plant. On the contrary, the Commission found that appellant's entire plant was used and useful on the date certain, saying in its tentative findings:

> "The inventory submitted by the company's witness, Williams, is complete and amazingly detailed. A complete check was made by State's witness, Hagenah, and other State's witnesses of the inventory and after that check the company's inventory was acceptable to all of the State's engineers and is therefore accepted by this Commission as the basis for valuation." (R. 128.)

This finding was never modified. There having been no non-useful plant upon which to predicate the claim of abnormal retirements, the claim falls of its own weight. Likewise the statement of the Supreme Court of Ohio (R. 578) that the Commission disregarded appellant's retirement experience during the period under investigation because the Commission found it to be abnormal, is without basis, because the Commission did not so find. The "abnormal" retirement theory was an afterthought of Commission's counsel. There was no evidence to sustain it, no finding of the Commission upon which it could rest.

The period of the Commission's investigation was one of great industrial and commercial expansion. In the years from 1925 to 1930 the number of appellant's telephones increased by more than 40% requiring an additional investment in plant of almost $65,000,000. (R. 191; 8361.)

To meet this unprecedented growth, large quantities of all classes of plant had to be retired because of inadequacy. The Commission simply refused to permit appellant to reimburse itself for the inevitable losses so occurring.

The physical unification of competing telephone properties was in the public interest. It was made with the

Commission's express approval. Even had there been a small amount of non-useful parallel plant, a condition which the evidence refutes, the Commission would not have been justified in refusing to provide reimbursement to appellant for its retirement.

Pacific Telephone & Telegraph Co. v. Whitcomb, 12 F. (2d) 279, 288;

Michigan Public Utilities Commission v. Michigan State Telephone Co., 228 Mich. 658, 200 N. W. 749;

Re Lincoln Telephone & Telegraph Co. (Nebraska Commission), P. U. R. 1930 E 210.

(b) The claim that in arriving at its allowance for the expense of depreciation the Commission gave consideration to appellant's retirement losses during the period following 1925 is wholly without foundation in view of the Commission's allowance which was $8,067,266 less than appellant's retirement losses during the years 1925 to 1933. (See table page 40, *supra.*) It is self-evident that if such losses were considered, it was only for the purpose of rejecting them.

(c) The argument that appellant fixed its rates of depreciation at excessive amounts, because at the time of its formation in 1921 appellant took over other companies whose reserves were insufficient, and by excessive depreciation rates attempted to build up such reserves, is also without merit. Appellant's reserve for accrued depreciation applicable to its intrastate property for the year 1925 was 13.87% of the cost of its depreciable property and $2,000,000 less than the depreciation existing in that property, as found by the Commission. Under such circumstances the question whether appellant's reserves in 1921 were adequate or whether its annual depreciation rates from 1921 to 1925 were proper can have no bearing upon the deter-

mination of its reasonable depreciation rates from 1925 to 1933. There was no evidence even tending to show that the rates during the years in controversy were excessive. Any inference to that effect could be drawn if, and only if, under appellant's depreciation rates during such years the accretions to the reserve were excessive. The Commission did not so much as suggest that they were. The following history of appellant's reserve accumulated under its depreciation rates shows the fallacy of such a claim:

Appellant's reserve for depreciation resulting from the application of its own rates was, in 1925, 13.87% of the cost of its intrastate depreciable property. The reserve for depreciation for the subsequent years accumulated by the application of appellant's annual rates was: 1926, 12.70%; 1927, 11.00%; 1928, 10.37%; 1929, 10.86%; 1930, 11.22%; 1931, 11.61%; 1932, 12.81%; 1933, 13.93%.* (See table page 15, *supra.*)

The argument that appellant's depreciation rates were fixed at excessive amounts in order to increase a reserve claimed to have been originally inadequate is thus demonstrated to be untrue, because the ratio of reserve to depreciable property at the end of the period under investigation was almost identical with that at the beginning of the period.

If one test of the adequacy of appellant's depreciation rates is their effect on the depreciation reserve, then, by a parity of reasoning, a similar test may fairly be applied to the Commission's allowance. By recalculating the reserve for depreciation *at the Commission's allowance,* the reserve of $12,156,070, or 13.87% of the depreciable property, existing in 1925 would in 1933 have been reduced to $3,908,911, or 2.64% of such property. (See table, page 15,

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* With the growth of plant there was, of course, an increase in the dollar amount of the reserve. But the significant figure is the percentage relation.

supra.) There could be no clearer demonstration of the inadequacy of the Commission's rates.

(d) An inference that appellant's rates of depreciation were excessive prior to 1932 is attempted to be drawn from the fact that in that year appellant voluntarily reduced its annual rates. The resulting composite percentage became 4.4% instead of 5.8%. (Wood Ex. 16, R. 8190 B.)

This reduction was made because the substantial loss of telephones experienced in 1931 had demonstrated that for the first time the growth of appellant's plant had been temporarily arrested. (R. 3640-2.)

Inadequacy is one of the important factors in bringing plant to the end of its useful life. (R. 1391-2; 3641-2; 3656-8; 3666.) At the time of the reduction it had become apparent that retirements due to inadequacy were entitled to less consideration than theretofore. (*cf.* table, page 40.) That this was the reason for the reduction is shown by the evidence. (R. 3640-2.) There was no evidence to the contrary. When appellant's plant was growing rapidly, substantial recognition was necessarily accorded the factor of inadequacy in fixing depreciation rates. When growth was arrested and the factor of inadequacy reduced, depreciation rates were reduced.

Forecast Used When Proof Available.

The Commission's allowance for depreciation upon the basis of appellant's retirement losses for 1921 to 1925 cannot be justified on the ground that necessity existed for a forecast of appellant's probable retirement experience in the future. The Commission fixed the allowance in 1934, when appellant's retirement experience for the entire period 1925 to 1933 was known and in evidence. Prophecy cannot be resorted to when proof is available.

West Ohio Gas Co. v. Public Utilities Commission of Ohio (No. 2), 294 U. S. 79, 82, 79 L. ed. 773.

Current Maintenance Expense.

The Commission allowed appellant's charges to expense for current maintenance in full. It is stated in the Commission's finding and in the opinion of the Supreme Court of Ohio that the Commission's action in this respect was liberal. (R. 199; 579.)

The maintenance expenses of a telephone company such as appellant are wholly different from those of an ordinary industrial enterprise. They include the cost of repairs to aerial and underground plant, central office equipment, and station equipment, and station removals and changes, none of which are provided for in the depreciation rates, and which are necessary to keep that property in a condition for continued efficient use. (R. 6946, 7018, 7023-7.) Most of the money expended for such current maintenance is for labor, with but small amounts for material. That the ordinary repairs to appellant's plant were necessarily substantial is understandable when the character and extent of that plant is considered. On June 30, 1925 appellant had more than 150 exchanges, 500,000 telephones, 650,000 poles, 150,000 miles of open aerial wire and 5,000 miles of underground and aerial cable. (Williams Exs. 7A and 7B, R. 7467-7748; 191; 7865.) Between 1925 and 1930 appellant's telephones had increased by more than 40%, the added net investment amounting to $65,000,000, with a resulting increase in all classes of plant and in the related current maintenance expense. (R. 191; 8361.)

The evidence is uncontradicted that all sums included in appellant's current maintenance account were spent for current maintenance and nothing else. (R. 3186-7.) Appellant's expenditures were recorded in accordance with the Interstate Commerce Commission's system of accounts. (R. 3635.) The Ohio Commission's accountant examined appellant's accounts, had access to the underlying data, and found nothing to criticize in any of them. (R. 3634-5;

Wood Ex. 12, R. 8182 B.) There was neither proof nor permissible inference that the current maintenance account had been availed of for the purpose of making capital additions.

In the hearings before the Commission there was no challenge to the necessity for or propriety of appellant's expenditures for current maintenance. That body accepted appellant's proof. Under such circumstances this Court has held that the correctness of such expenditures is not open to attack in a subsequent judicial proceeding.

West Ohio Gas Co. v. Public Utilities Commission of Ohio, (No. 1) 294 U. S. 63, 73, 79 L. ed. 761.

Apart from every other consideration, the fact remains that the Commission wholly disregarded appellant's proven depreciation experience and allowed for its expense of depreciation $8,067,266 less than appellant's retirement losses during the exact period for which the expense of depreciation was fixed.

(2) License Contract Costs.

American Telephone and Telegraph Company furnished to appellant and other Bell Associate Companies license contract services for which appellant currently paid a stated per cent of its gross revenues for services performed for it.

Prior to 1926 the percentage payment was 4½. After successive reductions the payment was fixed on January 1, 1929, at 1½%, where it has since remained. (R. 204.)

The services consisted of advice and assistance in engineering, plant, traffic, operating, commercial, accounting, patent, legal, financial, administrative and other matters relating to the economical conduct of appellant's business, the right to use all American Company patents, free from

liability for infringement, and the right to use all new apparatus and methods developed through the research and experimental work of the American Company. (R. 206-7.) Until 1928 the services included the furnishing to appellant of all receivers, transmitters and induction coils required in its business. (R. 204; 238; 3368.) The services were of a character not performed by appellant within its own organization and the expense incident to the services was not duplicated in whole or in part in any other expense account. (R. 5508-10; 5784-5.)

Of the total amount paid by appellant to the American Company for license contract services used in its intrastate business, the Commission disallowed for the years 1925 to 1932, inclusive, more than $2,800,000. Details of the costs and disallowances are shown in Appendices G, H, I, and J to the Commission's order of January 16, 1934, Appendix hereto, p. xi *et seq.* (R. 238-41.)

Before the decision in *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133, 75 L. ed. 255, appellant had offered substantial proof with respect to the license contract services. Following that decision the Commission received additional evidence on the subject, including all of the license contract evidence before the Statutory Court in *Illinois Bell Telephone Co. v. Gilbert*, 3 F. Supp. 595. (R. 724.)

The proof showed:

First. That the license contract services were needed and used by appellant, and valuable to it in the operation of its telephone plant. (R. 1540-1621; 1652-71; 5446-75; 5497-5501; 5508-87; 6122-6219; Kositzky Exs. A-1, A-20, A-21, A-31, R. 6869-6910; Kositzky Exs. 2, 13, 26, 28, R. 9345-9568.)

Second. That appellant's payments therefor during the period did not exceed the actual cost to the American Company of furnishing the services. (Ex. A-201-B, R. 8843; 236-41.) This cost was proved in

two steps: (a) there was shown the total annual cost to the American Company of each of its twelve departments engaged in furnishing some part of the services, and (b) there was eliminated from such total cost that part representing non-license contract services. (R. 3330-92; Heiss Exs. 10 to 19 inclusive, R. 6804 A-13; Heiss responses 1 to 4 inclusive, R. 8250-86; Ex. A-103, R. 8772; Exs. A-115, A-116, R. 8777-9; Exs. A-198, A-199, R. 8840-1.)

Third. That the allocation to appellant's intrastate business of its proportion of such cost was proper. (Heiss Exs. 22-27, R. 6815-7; Exs. A-108-B, R. 8773; Exs. A-112-B, A-113-B, R. 8776 A-B; Exs. A-117-B to A-119-B inclusive, R. 8781-97; Exs. A-124-B to A-161-B inclusive, R. 8801-17; Exs. A-167-B to A-170-B, R. 8826-35; Exs. A-200-B, A-201-B, R. 8842-3.)

Fourth. That the services were worth more than appellant's payments therefor. (R. 1452; 1548; 1559; 1590-3; 1610-21; 1665-71; 5462-7; 6030-44; Kositzky Exs. A-32 to A-35 inclusive, R. 6911-4; Kositzky Exs. 30 to 33 inclusive, R. 9569-72; Anthony Ex. A-4, R. 6312; Uprichard Exs. 13 to 16 inclusive, R. 7407-9; 1435.)

The Commission disallowed portions of appellant's payments, because it found, first, that a part of the services had not resulted to appellant's benefit and, second, that a part of the services were for the exclusive benefit of the American Company as a holding company. (R. 211; 210-19.)

There are twelve departments of the American Company rendering license contract services. The Commission considered the costs incurred by each of these departments as well as certain non-departmental costs. It allowed appellant's allocable share of the costs of some of these de-

partments in full, others in part, and still others it disallowed entirely.

The principal items disallowed are:

Department of Development and Research.

The Department of Development and Research is engaged in fundamental research work in the field of electrical communication. Every activity of that department has direct relation to the improvement and development of the business in which appellant has invested more than $162,000,000.

The principal purpose of the research work of the department, as stated by Dr. Jewett, its head, is:

> "to advance, improve and cheapen the cost of giving telephone service through the application of scientific knowledge to the betterment of the equipment and methods which we have available for giving that kind of service." (R. 4092.)

Notwithstanding the direct relation which the work of the department bears to appellant's operations, the Commission disallowed $601,370 of the department's costs allocable to appellant, including $436,315 incurred in the development of vacuum tubes and wireless (or radio) telephony. (R. 240.) The intrastate portion of the $601,370 was $580,575.

The Commission thus states its reason for the disallowance:

> "The State admits that this department does much to benefit the associated companies, but we are of the opinion that numerous expenses and costs claimed are not related to Ohio Bell Telephone operations and do not constitute a proper charge under the license contract. This appears self evident from the nature of the service for which the expenditures are made. We are disposed to and do eliminate and disallow all costs

and expenses incident to the following services and items: picture transmission, television, radio and submarine cable telephone connecting equipment and circuits, radio transmission systems, vacuum tubes, photoelectric cells and submarine cables." (R. 211-2.)

The Commission's statement that this development work was of no benefit to appellant is at complete variance with the evidence.

Appellant has been benefited by instrumentalities already in use in its plant as a result of such development work, as follows:

(a) Improved vacuum tubes.

(b) Transmitters and receivers of higher quality.

(c) The carrier system by means of which there are transmitted simultaneously over one pair of wires numerous telephone messages.

(d) The large use of fine wire cables.

(e) Improved and less expensive loading coils.

(f) The present successful type of handset.

(g) Dial interference elimination. (R. 4127-9; 4139-46.)

Dr. Jewett's testimony shows in detail that the above described instrumentalities were made possible as a result of the development work done in connection with the vacuum tube. (R. 4114-48; 4901-4; 4927-30; 4097.)

All of these instrumentalities are in constant use in all parts of the Bell system. (R. 4128; 4143.)

Since 1925 the use of vacuum tubes has increased rapidly in number and importance of function. (R. 4134-5.)

Vacuum tubes are used to amplify without distortion the electrical waves by which the human voice is transmitted over wire. (R. 4133.) They are as essential to a modern telephone plant as switchboards, wires and poles. Their use has resulted not only in improved service but lower plant costs than otherwise would have been possible. (R. 4096; 4134; 4138; 4143; 4148; 4153.) Vacuum tubes

have had a profound influence upon the transmission of speech over wire. Dr. Jewett's testimony discloses in detail the varied and important uses of these tubes in a modern telephone plant such as appellant's. (R. 4128; 4138.)

Originally invented to serve the needs of telegraphy, they have found a very large use in the field of telephony, principally because of the development work of the department. Their early use was largely confined to long distance telephony, but as new possibilities of use were developed, they revolutionized research work itself and provided the foundation for a dozen or more branches of the telephone art. (R. 4127-30; 4133-4; 4137-9.) They are used in large numbers in local exchange plants in connection with automatically switched-in repeaters, special substation sets for the hard-of-hearing (which includes 10 per cent of the population), local distribution of news and music, time service, teletypewriter units, and in instrumentalities used in locating sources of trouble in the telephone plant. (R. 4145-4148.)

Not only are the instrumentalities resulting from this development work essential to appellant's daily operations, but the work was undertaken by the American Company for the benefit of appellant and other Bell Associate Companies, with the following essential purposes in view:

(1) To maintain such a position that the Bell Associate Companies could not be threatened by any strong patent situation developed in the field of wireless telephony.

(2) To explore that field in order to apply the resulting developments to wire telephony.

(3) To enable the Bell Associate Companies to serve the public by wireless telephony if and when such service may be in the public interest. (R. 4115-8.)

The Commission's disallowances were arbitrary. It substituted its unsupported conclusion that the services

rendered were of no benefit to appellant for the undisputed fact that they were indispensable to the economical and efficient operation of appellant's plant.

The other items of development cost disallowed were on account of research work in respect of submarine cable, television and the like.* This work, all related to the art of telephony, was reasonably undertaken in the public interest and appellant should have been allowed to treat its proportion of the cost as a proper operating expense. In principle, the following language of this Court, in considering the expense of procuring new business, in *West Ohio Gas Co. v. Public Utilities Commission of Ohio* (No. 1) 294 U. S. 63, 72, 79 L. ed. 761, is applicable here:

> "Good faith is to be presumed on the part of the managers of a business. • • • In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay. • • • Within the limits of reason, advertising or development expenses to foster normal growth are legitimate charges upon income for rate purposes as for others. • • • When a business disintegrates, there is damage to the stockholders, but damage also to the customers in the cost or quality of service."

The Commission's attitude in dealing with these and kindred license contract costs was fundamentally unsound. Even if, contrary to the fact, the development and research work had not resulted in improved devices and instrumentalities, it was reasonably undertaken, had direct relation to appellant's business, and the cost thereof was a proper expense. The Commission's action was an unreasonable interference with a prudent outlay, necessary if appellant was to continue to render proper service.

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* More than $100,000 of submarine cable is in use in appellant's plant for river and lake crossings. (Brett Ex. 8, R. 6346.)

Contingent Liability For Patent Infringement.

In the license contract the American Company agreed to hold appellant and other Bell Associate Companies harmless against damages for patent infringement on account of devices recommended by it for use by the Associate Companies. (R. 206; 6794-5.) In order to provide against possible losses resulting therefrom the American Company set up a reserve. The Commission disallowed appellant's allocable part of the charges thereto in the sum of $985,436. (Exs. A 201 B and A 113 B, R. 8843; 8776 B.) The amount allocable to appellant's intrastate business was $953,191.

The Commission's reason for the disallowance was that

> "The possibility of infringement damage is too remote to charge the rate payer for a cost or expense which does not exist and not likely to arise when we consider that during all the years from 1925 to the present time there has been no cost to the American Company in the way of loss or damages because of patent infringements of apparatus used by the patrons of the Ohio Bell Company." (R. 218.)

By the end of 1931 the American Company and its subsidiary, Western Electric Company, owned or controlled outright, or owned licenses under, more than eight thousand United States patents and had over two thousand patent applications pending. (R. 4457.)

Western manufactures and sells to the Associate Companies more than one hundred thousand different piece parts and more than twenty thousand kinds of telephone apparatus. (R. 3915.) This, in conjunction with the rapid growth of the art and consequent patent activity, gave almost unlimited opportunity for patent controversies. There was continuous controversy with other manufacturing companies and inventors, and frequent charges of infringement were made against the Associate Companies. (R. 4462-4.)

During the present case there were pending two patent suits against licensee companies, involving the claim that much of the switching apparatus in every Bell manual central office infringed the plaintiffs' patents. The amount which the plaintiffs expected to recover aggregated several hundred millions of dollars. (R. 4463-4.) Obviously, if plaintiffs should succeed, every Bell Associate Company would be subjected to large claims for damages for which the American Company was, under the license contract, bound to indemnify them.

Against possible losses resulting from its obligation to insure all the Associate Companies against patent infringement liability, the American Company made transfers to a contingent reserve, aggregating, during the period in controversy, $24,395,799. (Ex. A 201 B, R. 8843.)

Whether the provision made by the American Company against this liability was proper both in character and amount, and whether an Associate Company was justified in including in its operating expenses its proper share of the cost thereof was submitted to the Statutory Court in *Illinois Bell Telephone Co. v. Gilbert*, 3 F. Supp. 595, (reversed by this Court on other grounds) on evidence all of which was before the Commission by stipulation in the present case. (R. 724.) That court, after full consideration, approved the provision as proper. The reasons for the approval are thus well stated (p. 604):

> "Under the license contract, the American Company was obligated to insure and hold harmless the plaintiff and all of the other licensee companies against loss or damage from suits or judgments for infringements of any patents, when such infringement was the result of the use of any apparatus recommended to such licensees by the American Company. That obligation constituted a substantial liability and one which might subject the American Company to large losses. The American Company provided for meeting such

possible losses by setting up a contingent reserve over the period from January 1, 1923, to January 1, 1932. Such provision was a reasonable one, and it was proper to distribute the amount so set up over a number of years rather than to charge heavy losses in particular years when incurred. The only practical way by which plaintiff and other licensee companies could make compensation to the American Company for that undertaking was to charge against their revenues fairly equal amounts over the period covered by the undertaking of the American Company."

Treasurer's Department.

This department services the securities of the American Company outstanding in the hands of the public. (R. 3351.) The money obtained from the sale of these securities has been invested by the American Company in the properties of the Associate Companies, including appellant, and in corporations which the American Company has formed to serve those companies, viz., Western Electric Company and Bell Laboratories, Inc. A minor part of the money has been invested in non-license activities. (R. 4234; 4243.) The work of the department in connection with securities consists of the issuance of stocks and bonds, stock transfers, bond registrations, the payment of dividends and interest, correspondence with investors and other related activities. (R. 3351.)

Inasmuch as appellant's treasury is relieved of these costs, the effect of the Commission's disallowance of appellant's proper share is to eliminate one of the necessary costs of operation.

This department also cares for the wages and expenses of the American Company's general departments rendering license contract services. Manifestly some department must perform this service, and to the extent that the research, engineering, advisory and other departmental services are properly attributable to appellant, it should also

be charged with its pro rata share of the cost of handling funds with which to pay the expenses of the departments rendering the services.

Of the total cost of the services of the treasurer's department, the Commission allowed $7,118, and disallowed $397,971. (R. 239.) The intrastate portion of the disallowance was $384,379.

Personnel Department.

The Commission disallowed a portion of the costs of this department allocable to appellant's business, aggregating the sum of $42,953, exclusive of the disallowed item of "Interest on Employees' Benefit Fund," as to which latter item no complaint is here made. (R. 239; 240.) The intrastate portion is $41,504.

The good relations between the management of the Bell System and its employees are a matter of common knowledge. A department to care for relationships with employees is equally as important as one to care for matters of research or engineering. It is not only important to see that the proper items of telephone equipment are developed, conserved and maintained, but fully as important to see that the proper employees are brought into the system, placed in the right capacities and not subjected to improper treatment or undue occupational burdens.

The Personnel Department renders assistance to and cooperates with the Associate Companies in adopting and maintaining measures and methods that will:

> Assure management's consideration of employee point of view in all matters affecting employee interests and encourage employees to discuss with management their individual and group relations.
>
> Enlist interest and develop employee understanding of their responsibilities to the service and to the public.

Provide the training necessary to bring out the best in each individual and encourage the use of educational opportunities.

Develop voluntary thrift habits among employees which will tend to strengthen their economic security and promote good citizenship.

Assure sound practices in matters relating to benefit payments, emergency loans, and retirement pensions.

Develop sound practices in company medical work and promote good-health habits among employees.

The department keeps informed of the trend in industrial relations including major developments in other industries. It administers the benefit and medical work of the American Company. It also maintains contact with the various associations of the non-Bell connecting companies and advises with the Associate Companies in their relations with those companies, all in the interest of the best national telephone service. (R. 3344-7.)

The Commission stated (R. 212) that it appeared to it "that the scope of the work of this Department is rather in the interest of the holding company than that of the licensee"; but its disallowance was obviously due to a misunderstanding of the evidence. This is so because the special training work of the Personnel Department relates to the training of employees of the Associate Companies and of the Long Lines Department of the American Company. In calculating the portion of the cost allocable to the Associate Companies, the portion of the total cost referable to the training of Long Lines employees was deducted. (R. 3337; 3345.) Any incidental training of the staff employees of the general departments of the American Company is wholly minor in extent, but even this work

would properly be assignable to license contract costs, since it applies to American Company employees engaged in license contract activities.

Comptroller's Department.

The Commission disallowed the sum of $200,390 representing a portion of the cost of the Comptroller's Department allocable to appellant's business. (R. 239.) The intrastate portion of the disallowance was $193,580.

This department of the American Company assists in the work of financing temporarily the Associate Companies and of accounting for funds held available to meet their requirements. It keeps general books and records for the purpose of showing the expenses of the twelve departments of the American Company furnishing license contract services. It compiles accounting and statistical information and furnishes it to the Associate Companies. (R. 3348-50.)

The amounts disallowed were chiefly those relating to the general books and records kept by the department, the expenses of the chief statistician and the cost of compiling Bell System Reports. (R. 214.) Of the administrative expenditures of this department the Commission disallowed one-half. (R. 239.)

It is the function of the chief statistician of the American Company to develop methods for use by the Associate Companies, including appellant, in analyzing the various phases of their business, and to develop information for all grades of supervisory employees. He also makes the necessary studies for determining the pension accrual plans of the Associate Companies and studies their fire insurance problems. (R. 3349; 4258.)

The Bell System Reports section is a clearing house for information emanating from the Associate Companies and required by the research and advisory organization of the American Company in order more efficiently to render

the license contract services to such companies. (R. 4259.) No reason is stated in the Commission's finding for the disallowance of appellant's allocable portion of the cost of the chief statistician and the Bell System Reports, and it is difficult to find a reason upon which such a disallowance could be based.

Inasmuch as the twelve departments of the American Company render many license contract services, it is essential that the cost of rendering such services be accurately recorded. It was only appellant's allocable share of that portion of the cost of the Comptroller's Department attributable to license contract service which appellant sought to include in its expenses and which was rejected by the Commission.

III. REFUNDS ARBITRARILY ORDERED.

Assignments of Error 7 and 8.

The Commission ordered appellant to refund the aggregate sum of $11,832,264 for the years 1925 to 1932, inclusive. These refunds were arrived at by the following method:

The Commission first undertook to determine for each of the years 1925 to 1933 the amount, if any, by which appellant's earnings from its entire intrastate business, both toll and exchange, exceeded a fair return on the value of its intrastate property. To do this, the Commission found for each such year, with respect to the intrastate business and property as an entirety:

First. The value of the property.

Second. The fair rate of return.

Third. The dollar amount of such fair return.

Fourth. The revenues, adjusted expenses, and resulting net income.

Fifth. That the resulting net income exceeded the fair return on the property value fixed by the Commission by the following amounts:

1925	$1,822,647
1926	2,041,483
1927	1,986,610
1928	1,925,301
1929	1,463,347
1930	1,481,689
1931	1,659,760
1932	908,335
1933	Nothing
Total	$13,289,172

The Pence law (and the bonds executed pursuant to it) authorize refunds to be made only (a) in the "bond" cases, (b) to the persons whose rates were increased in those cases, and (c) in the amount by which the increases were "unreasonable or excessive." The Commission so understood the statute and undertook to give it effect accordingly. This is in accord with its plain meaning. The bonds given pursuant to the statute, which the Commission approved, were to secure the performance of the obligation as thus defined and are the measure of appellant's obligation. The only rates of appellant which were in suspense and subject to refund were the rates which had been increased in the bond cases. All other rates in the bond cases and all rates, whether increased or not, in the non-bond cases, were lawful and final unless and until other rates for the future were prescribed or authorized by the Commission. They were the lawfully filed rates and were reasonable rates in contemplation of law. No part of the revenues derived from these rates was refundable. Those revenues were the property of appellant.

City of Lima v. Public Utilities Commission, 106 Ohio St. 379, 386, 140 N. E. 147, 149;

Great Miami Valley Taxpayers Assn. v. Public Utilities Commission, 131 Ohio St. 285, 2 N. E. (2d) 777 (June, 1936).

It is clear, therefore, that the total "excess earnings," referable as they were to the entire intrastate property, were not refundable and afforded no basis upon which an order of refund could be made.

Commission's Method of Apportionment.

The Commission, recognizing that under the statute and the decisions of the Ohio Supreme Court refunds could be ordered of revenue attributable to bonded rates only, next undertook, by means of an accounting apportionment hereafter discussed, to determine for each year the refundable portion of the $13,289,172 of total excess intrastate earnings. The decision here under review purports to accomplish this and orders appellant to make refunds to persons whose rates were increased under bond, in the following amounts:

Year	Exchange	Toll
1925	$1,137,195	$232,282
1926	1,637,314	176,845
1927	1,823,857	Nothing
1928	1,772,238	"
1929	1,344,624	"
1930	1,357,589	"
1931	1,519,405	"
1932	830,915	"
1933	Nothing	"
Total	$11,423,137	$409,127

These refunds, arrived at as they were by the apportionment method, were ordered to be made without any find-

ing by the Commission for any year of the property value, or net income in the bond cases.

It is appellant's contention here, as it was before the Commission (R. 395-401; 344-6), and in the Supreme Court of Ohio (R. 96-8; 450-4), that the method employed by the Commission for ascertaining the refundable portion of the excess earnings was wholly arbitrary and has resulted in overstating by more than $4,000,000 the amount which appellant could be required to refund.

An understanding of the method used by the Commission fully sustains this contention.

The refundable portions of the excess earnings were fixed by an apportionment based on *gross exchange revenues*. To make the apportionment the Commission ascertained for each year:

First. The total amount of gross exchange revenues collected in all of appellant's exchanges.

Second. The amount of gross exchange revenues collected in appellant's exchanges where one or more of the increases in rates were collected under bond.* (In none of these exchanges were all of the rates under bond. R. 8429-8574.)

Third. The percentage relation of the gross exchange revenues in the exchanges where bonds were in effect to the total gross exchange revenues.

Having ascertained this percentage, the Commission applied it to the total excess earnings which it found appellant had had from its entire intrastate business and ordered the resulting amount to be refunded as representing the portion of the excess earnings collected under bond. (R. 3738-57; 3760-76; 3797-3800; Wood Exs. 21 and 22 and Wood Report of August 11, 1934, R. 8193-8212.)

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* In 1925 there were 37 out of 153 exchanges in which one or more rates had been increased under bond. Due to additional Pence Law filings there were 45 such exchanges in 1928. (R. 378.)

Errors in Commission's Method.

The purpose of the apportionment was to ascertain the refundable portion of the excess earnings or, in other words, what portion of the excess earnings was attributable to the bonded increases.

There are at least three vices inherent in the Commission's method:

First, it adopted, as the basis for the apportionment of excess net earnings, appellant's total *gross* exchange revenues, which, since they bore no relation to appellant's total *net* earnings, or to its *net* earnings in the bond or non-bond cases, afforded no basis upon which an apportionment of excess net earnings could be made. Also, although the Commission's method undertook to apportion a part of the excess earnings to toll refunds, all toll revenues were left out of the calculation.

Second, the Commission counted or treated as revenues collected under bond, all revenues, whether bonded or not, of each exchange where any rate was collected under bond. It thereby increased for each year the percentage to be applied to that year's excess earnings, and required appellant to refund more than $4,000,000 of revenues not collected under bond.

Third, although the Commission's apportionment method took into consideration *exchange* revenues only, no account of toll revenues being taken, a part of the excess earnings found for two of the years (1925 and 1926) were apportioned to appellant's toll business and toll refunds ordered for those years. For these refunds there was no factual basis.

With respect to the first proposition:

In making the apportionment the Commission, after rejecting appellant's offer to prove that its earnings referable to its bonded rates were reasonable (See page 12, *supra*),

proceeded to apportion the excess net earnings between the bonded and non-bonded rates solely upon the basis of gross exchange revenues, on the assumption that an apportionment based on gross revenues would fairly reflect the amount of net earnings.

In *The Minnesota Rate Cases*, 230 U. S. 352, 459, 57 L. ed. 1511, this Court, condemning the use of gross earnings for apportioning or dividing property values as between interstate and intrastate use, said (p. 459):

> "In support of this method, it is said that a division of the value of the property according to gross earnings is a division according to the 'value of the use,' and therefore proper. But it would seem to be clear that the value of the use is not shown by *gross* earnings. The gross earnings may be consumed by expenses, leaving little or no profit. If, for example, the intrastate rates were so far reduced as to leave no net profits, and the only profitable business was the interstate business, it certainly could not be said that the value of the use was measured by the gross revenues."

By a parity of reasoning, in the present case the gross earnings furnish no valid basis for a division or apportionment of excess earnings (which of course are net earnings) as between the bond and non-bond cases. Not only is there no evidence to support such a division or apportionment but, to the contrary, the record discloses that appellant's more than 150 exchanges located in the cities and towns of Ohio are operated under varying conditions in respect of population, number of telephones per community and use of classes of service, and that the cost of rendering the service varies proportionately as between the larger communities and the smaller ones. (R. 124-5; 4171; 4096; 191; 6240; 6243-4; 1625; 1630; 8429-8574.)

Appellant's revenue for the years 1925 to 1932 in exchanges where there were no increases collected under

bond amounted to approximately $25,000,000. (R. 6347; 6348.)

The Commission's apportionment method gives no consideration to net earnings, to the varying amounts of bonded increases as between different classes of rates and different sizes of exchanges, to the relation which an increased rate bore to the pre-existing rate, to the character of the several exchanges furnishing the service, or to the cost of rendering that service. The method used had no substantial relation to the object sought to be accomplished, viz., the determination of excess net earnings in the bond cases, and was therefore purely arbitrary.

By making the apportionment of excess earnings (which included earnings from both the toll and the exchange property) on the basis of gross exchange revenue, the Commission excluded from consideration $51,470,911 of toll revenue, of which only $4,981,394, or less than 10%, represented increases in toll rates collected under bond. (R. 8733.)

With respect to the second proposition:

In none of appellant's exchanges where rates were increased under bond were *all* of the rates increased. (R. 8429-8574.) In many of the exchanges only a few of the rates were so increased. (R. 8429-8574.) For example, in the Cleveland exchange the increases collected under bond represented less than 1% of the total exchange revenues of that exchange.

Nevertheless, in making the apportionment, the Commission treated or counted as bonded revenue all exchange revenue in every exchange where any rate was increased under bond. (R. 3740; 8193-8212.)

Thus for the Cleveland exchange alone the Commission treated as bonded revenue more than $102,000,000

which had not been collected under bond and with respect to which appellant could not be required to make refunds. The testimony of Commission's witness, Wood, and appellant's witness, Brett, and their exhibits show the following in connection with the Cleveland Exchange revenues:

CLEVELAND EXCHANGE

Year	Total Exchange Service Revenues	Increases Collected Under Bond	Non-Bonded Revenues Counted as Bonded Revenues
1925	$ 10,569,289	$ 86,717	$ 10,482,572
1926	11,382,795	92,976	11,289,819
1927	12,070,390	99,160	11,971,230
1928	12,903,220	102,841	12,800,379
1929	14,317,661	113,937	14,203,724
1930	14,713,833	118,367	14,595,466
1931	14,573,563	115,487	14,458,076
1932	13,146,846	108,515	13,038,331
Total	$103,677,597	$838,000	$102,839,597

(Brett Ex. 9, R. 6356.)

The result of the Commission's treatment of the $102,839,597 of non-bonded revenue of the Cleveland exchange as bonded revenue was to increase the refunds by more than $4,000,000. That this is true appears from the following table:

Year	Exchange Service Revenues: Company Total	Cleveland Exchange	% of Total (3 ÷ 2)
(1)	(2)	(3)	(4)
1925	$ 24,554,400.	$ 10,569,289.	43.044379%
1926	26,628,407.	11,382,795.	42.746812
1927	28,617,757.	12,070,390.	42.177974
1928	30,447,906.	12,903,220.	42.378021
1929	33,431,682.	14,317,661.	42.826625
1930	34,422,892.	14,713,833.	42.744325
1931	33,722,537.	14,573,563.	43.216093
1932	30,038,321.	13,146,846.	43.766914
Total	$241,863,902.	$103,677,597.	

Year	Total Excess Earnings Found by Commission	Excess Earnings Attributable to Cleveland by Commission's Method (6×4)	Total Possible Refunds in Cleveland i.e. Total Increases Collected under Bond	Excess Refunds Ordered, due to the Use of All Cleveland Revenues as Bonded Revenues (7—8)
(5)	(6)	(7)	(8)	(9)
1925	$ 1,822,647	$ 784,547	$ 86,717	$ 697,830
1926	2,041,483	872,669	92,976	779,693
1927	1,986,610	837,912	99,160	738,752
1928	1,925,301	815,904	102,841	713,063
1929	1,463,347	626,702	113,937	512,765
1930	1,481,689	633,338	118,367	514,971
1931	1,659,760	717,283	115,487	601,796
1932	908,335	397,550	108,515	289,035
Total	$13,289,172	$5,685,905	$838,000	$4,847,905

(Compiled from Reports of Aug. 11, 1934 of Commission's witness, Wood, Exhibit 9 of Appellant's witness, Brett, and Finding of January 16, 1934; R. 8210A-11; 6356; 244.)

If appellant had not increased any of its rates in Cleveland under bond and had thus reduced its revenue in Cleveland for the eight-year period by only $838,000, no refunds could have been ordered in Cleveland, and in such case the Commission admittedly could not have included as bonded revenue any portion of Cleveland exchange revenues. Thus, under the Commission's method of apportionment appellant by increasing its rates in Cleveland to the extent of only $838,000 has lost the sum of $4,847,905, due to the Commission's counting, as bonded revenue, all revenue collected in that exchange. Surely a method which makes such a result possible is wholly arbitrary.

With respect to the third proposition:

As heretofore shown, the Commission's apportionment method was based upon gross *exchange* revenues only, no account having been taken of toll revenues and no consideration having been given to the value of the toll property or net income therefrom. (R. 3740; 3748; 3773; Wood Exs. 21, 22, and Wood Report of August 11, 1934, R. 8193-8212.) There was, therefore, no possible basis upon which toll refunds could be ordered. But, after having ordered exchange refunds totaling the entire amount of exchange increases collected under bond for the years 1925 and 1926, $409,127 remained. This amount, which could not be absorbed by way of exchange refunds, was thereupon arbitrarily assigned to toll refunds and ordered repaid to toll patrons. (R. 3754; 3757; 3762; Wood Exs. 21, 22 and Wood Report of August 11, 1934, R. 8193, 8194-8212.) This was done in accordance with the apportionments made by the Commission's accountant, Wood, who admitted that the amount ordered refunded to toll patrons was merely the "leftover," not absorbable by way of exchange refunds. (R. 3757; 3762.)

This was not a case where a sum of money was admittedly due to a number of persons and the debtor had no

interest in the distribution of the amount owed by him among the several claimants. On the contrary, it was a case where, as heretofore pointed out, appellant's obligation was to refund only that portion of the bonded increase in rates which the Commission might determine to have been excessive.

Appellant was, therefore, vitally interested in the determination of the amount of the refunds. It had the undoubted right under the Ohio law to collect and retain for its own uses all revenues not collected under bond. The Commission had no authority to deal with such revenues or to order refunds with respect thereto.

In conclusion on this subject, (a) the Commission, in arriving at the refundable portion of the excess earnings, used a method based solely upon appellant's gross exchange revenues, having no real relation to appellant's actual net earnings, and thus ascertained upon a wholly arbitrary basis that portion of appellant's excess earnings attributable to the bond cases; (b) it also treated as bonded revenue more than $100,000,000 of revenue not in fact bonded and, as a result, required appellant to refund more than $4,000,000 of excess earnings not in fact referable to rates collected under bond; (c) the Commission's order requiring appellant to refund more than $400,000 to its toll patrons had no factual basis upon which it could rest. This amount was an accidental residue arbitrarily assigned to toll refunds as a "leftover."

The Commission's action in these respects amounted to a denial of due process of law because based on no evidence.

Baltimore & Ohio Railroad Co. v. United States, 264 U. S. 258, 68 L. ed. 667.

IV. SEPARATION OF PROPERTY, REVENUES AND EXPENSES.

Appellant made a careful separation of its property, revenues and expenses as between its interstate and intrastate business on the basis of use, in conformity with the decision in *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133, 75 L. ed. 255.

The separation was accepted by the Commission and used as the basis of its findings. Its correctness is not questioned. (R. 51.)

V. VALUATION.

Assignments of Errors 11, 12 and 13.

The Commission's property valuation was erroneous in the following particulars*:

(1) Omitted Land.

On June 30, 1925 appellant owned seven parcels of land of the aggregate value (intrastate) of $586,959, all purchased as sites for telephone exchange buildings.

On some of the parcels telephone buildings were already under construction on the date certain. (R. 3214.) Within a reasonable time thereafter, all of the parcels were in actual use. (R. 233.)

There is shown below in column (1) the value of the intrastate portion of each parcel and in column (2) the date when the buildings under construction thereon were finished and placed in service:

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* The errors considered in this section are in addition to the point argued *supra*, pages 25 to 37 with reference to the use of price trends.

Parcel	(1) Value	(2) Buildings Finished and Cut into Service
No. 17—Columbus	$ 2,362	April, 1925
No. 21—Cleveland	33,635	June, 1926
No. 8—Toledo	154,776	April, 1927
No. 19—Cleveland	300,945	May, 1927
No. 18—Columbus	19,728	February, 1928
No. 1—Springfield	21,867	October, 1928
No. 17—Cleveland	53,646	December, 1929
Total	$586,959	

(R. 233; 243.)

The Commission recognized the propriety of appellant's purchase and use of this land, by including each parcel in the rate base for the year in which the building on the parcel was placed in active service, but refused so to include any parcel until that year, thus undervaluing appellant's intrastate property in 1925, 1926, 1927 and 1928 in the respective sums of $586,959, $550,962, $95,241 and $53,646. (R. 233; 243.)

Parcels of land purchased by a public utility as sites for buildings or other structures reasonably necessary to serve the public must be included in the rate base where, as here, they have been purchased for use prior to the date certain and are used in serving the public within a reasonable time thereafter.

Denver Union Stock Yard Co. v. United States, 57 F. (2d) 735;

Brooklyn Borough Gas Co. v. Prendergast, 16 F. (2d) 615;

Pacific Telephone & Telegraph Co. v. Whitcomb, 12 F. (2d) 279.

In *Denver Union Stock Yard Co. v. United States*, the Statutory Court enjoined a rate order of the Secretary of Agriculture because, among other things, of his refusal to include in the rate base unimproved parcels of land acquired for stockyard expansion, material yards, additional trackage facilities and railroad car storage deemed necessary by the company for use in the reasonably near future. The court said (p. 746):

> "By denying the petitioner a right to earn a return thereon, the Secretary has, as a practical matter, denied the petitioner the right to own them, for it is mathematically certain that, if the petitioner is not permitted to earn a return upon the value of such properties, it cannot afford to keep them. • • •.
>
> "To have waited until the adjacent property was improved, or until the owners could have taken advantage of its imperative need, would be to saddle upon the patrons an extravagant and unnecessary load."

The exclusion of this land from the rate base cannot be justified, as the Commission attempts, on the ground that the Ohio statutes do not specifically authorize its inclusion.•

> *Columbus Gas & Fuel Co. v. Public Utilities Commission of Ohio*, 292 U. S. 398, 404, 78 L. ed. 1327.

The Commission's refusal to include this land in the rate base until the buildings were placed in active service denied appellant an opportunity to earn a return on property in which it had been required to invest its money in order to meet the public demand for service.

• Sections 499-8 to 499-12, inclusive; appendix hereto, pages xxix to xxxiii.

(2) Going Value.

In its finding of tentative value as of June 30, 1925 the Commission made a separate allowance of $3,592,040 for going value, equal to 3¾% of the reproduction cost new. (R. 144; 147.) Of that amount the intrastate portion was $3,490,905.

In its final value as of June 30, 1925, the Commission eliminated its previous allowance for going value, made additional reductions in the tentative value of approximately $4,000,000 and no increases. (R. 247.)

The issue in respect of going value calls for a consideration of the history and circumstances of the particular enterprise.

Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U. S. 287, 314, 77 L. ed. 1180;
Dayton Power & Light Co. v. Public Utilities Commission of Ohio, 292 U. S. 290, 309, 78 L. ed. 1267.

Appellant's Experience at its Collected Rates.

Appellant was formed in 1921 by the consolidation of the former Ohio Bell Telephone Company and The Ohio State Telephone Company. (Hagenah Ex. 1, R. 6541; 6542; Company Ex. X-3, R. 6358.)

At its collected rates, including the portion found to be excessive, appellant from its organization in 1921 to the end of the period under investigation had paid dividends on its common stock at an average annual rate of 5.27%. For no year of the period did the dividends exceed 7%. (R. 8364; 8414-5; 8418, Wood Exs. 1 and 4, R. 8171; 8174.) Appellant's entire capitalization, approved by the Commission, has never exceeded its investment. (Wood Ex. 1, R. 8171; 8361; 8364; 8414; 8415; Uprichard Ex. 4, R. 7397; Eide Ex. 1, R. 6489; 8338.)

For 1925, appellant's reserve for accrued depreciation amounted to $12,156,070, which was 13.87% of the cost of the intrastate depreciable property, and $2,000,000 short of the amount deducted by the Commission from the reproduction cost new of the entire intrastate property on account of existing depreciation as of the date certain. (See table page 15, *supra.*)

During the period 1925 to 1933, the depreciation reserve ranged from a low of 10.37% of the cost of the depreciable property to a high of 13.93%. (See table *supra*, p. 15.)

As of June 30, 1925 appellant's corporate surplus amounted to $3,759,829 and on November 30, 1933, the end of the period, it was $2,813,345. (Wood Ex. 1; R. 8171; and R. 8416.)

The foregoing history reflects appellant's operations at its collected rates, of which the Commission's final order would require the refund of approximately $12,000,000 with interest.

Property.

Appellant's property represents a large integrated aggregate of many classes and kinds of telephone plant. It is a well conceived project, favorably located. Its construction and equipment are modern. It is efficiently operated, well managed and has shown an earning power if granted reasonable rates. (R. 2080.) In 1925 it had more than 500,000 telephones in service and a trained organization of 12,100 employees engaged in the construction, maintenance and operation of its plant. (R. 191; 1343; Uprichard Ex. 5, R. 7398.)

Going Value—Commission's Tentative Finding.

Except for minor adjustments, the Commission arrived at the tentative value as of June 30, 1925 by adopting for the several physical property costs, direct and overhead, the estimates of its engineer, Hagenah, and to those costs added its allowance of 3¾% for going value. (R. 144; 147.)

Hagenah had made a separate allowance for going value because none of his other costs, direct or overhead (indirect), contained any amount or allowance for that item. (R. 2186.) They were physical property costs only. The same was true with respect to the costs, direct and overhead, of all of the other appraisal witnesses. (R. 830; 831; 1189; 1205; 1759; 2186; 2783.)

In view of such evidence a separate allowance for going value was inevitable, the Commission in its findings of tentative value saying:

> "The Commission wishes to reiterate that this estimate of going concern value is fixed in this case under our view that the Commission is bound by the evidence in the record * * *." (R. 139.)

Going Value—Commission's Final Finding.

In its final finding of value as of June 30, 1925, the Commission disallowed *in toto* the tentative finding for going value and further reduced the tentative finding by $4,000,000. (R. 173; 247.)

Between the dates of the two findings there had been no change in the pertinent evidence.

The resulting final value of the intrastate property as of the date certain was in the aggregate more than $7,600,000 below the tentative value. (R. 196, 247.)

It was more than $5,000,000 below the cost of the property including the Commission's allowance for working capital and supplies.

The course followed by the Commission in reaching its final finding without any amount for going value, is worthy of note.

Hagenah's direct and overhead physical property costs were more than $12,000,000 below appellant's costs, the latter based on its recent experience in large construction projects. (R. 1105-6; 1758-9; 2066.)

In its tentative finding the Commission adopted Hagenah's physical property costs, direct and overhead, presumably because they were the lowest credible costs in the record.

The physical property costs thus adopted contained no allowance for going value. (R. 2186.)

Recognizing that those costs contained no such allowance, the Commission in its tentative finding added to Hagenah's costs the 3¾% for going value.

The effect was to establish the existence of a going value in the property and to concede that no allowance for it had been made in the Commission's physical property costs.

In the final value, still using the same or lower costs containing nothing for going value, and disallowing entirely its previous allowance for that element, the Commission labeled the resulting amount "fair value."

What had become of the substantial going value previously found to exist in the property or where an allowance therefor in any amount was to be found in the final value, the Commission did not say.

Manifestly, a final value thus made up of costs from which any amount or allowance for going value has been excluded cannot, in the nature of things, fairly be said to be *large enough* to satisfy the constitutional requirement that

there must be an actual allowance in good faith in the rate base for that value. The narrow issue here is, whether, measured by the evidence, the rate base "was in fact large enough" to embrace a fair allowance for going value.

Los Angeles Gas & Electric Corp. v. Railroad Commission, 289 U. S. 287, 317, 77 L. ed. 1180.

It is immaterial whether the allowance for going value is or is not so labeled. Nevertheless, where the record affirmatively shows, first, the inclusion of a separate allowance for going value because there was no allowance for it in the other costs; later the exclusion of that specific allowance and the substitution of nothing in its place; and finally, no possible room elsewhere in the rate base for any amount representing that element of value, the claim that somewhere, in some way, there is present in the final value some amount or allowance for going value merely denies the realities. In the face of the record here, such a claim is futile. Constitutional guaranties cannot be satisfied by mere gestures.

On the facts, the fair value in the instant case is the antithesis of that in *Los Angeles Gas & Electric Corp. v. Railroad Commission, supra.* There the Commission's fair value or rate base was greater by $5,000,000 than the historical cost of the property undepreciated. Here the rate base was more than $5,000,000 *below cost.* (See table page 15, *supra.*)

In the opinion in that case, at page 317, the Court said:

> "this excess amount of over $5,500,000 can appropriately be assigned to elements of value which may not have been fully covered • • • and thus the entire excess may be regarded as applicable to whatever intangible value the property had as a going concern."

In the present case no amount can be so assigned. There is no such excess. In the Commission's final value,

bottomed as it is upon costs containing nothing for going value, there could not be any amount or allowance for that item. *Measured by the evidence*, there is nothing in the final value beyond tangible, physical property costs.

In *Denver v. Denver Union Water Co.*, 246 U. S. 178, 62 L. ed. 649, the master's allowance for going value was approved because (p. 192):

> "the master expressly declared that his detailed valuation of the physical property and water rights included no increment because the property constituted an assembled and established plant, doing business and earning money; and a careful examination of his very elaborate report convinces us that this is true. The amount allowed by him on this account is not open to serious question from the standpoint of appellants."

If there be substituted for the master's valuation in that case the physical property costs of the Commission's engineer, adopted in the instant case, the situation presented by the two cases is the same.

In *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 71 L. ed. 316, the Indiana Commission added a substantial amount for going value because in the physical property costs its engineer had included nothing for that element. That is precisely what the Commission did in the tentative value in the instant case, only to undo it in the final value.

That a going value existed in appellant's property in a substantial amount was established by the evidence of every witness testifying on the subject. They included Sloan, Williams and Schneider for appellant, and Hagenah for the Commission. (Schneider Ex. 3, R. 7121-7228A; Williams Ex. 9, R. 8159-60; Sloan Ex. A-1, R. 7388-90A; Hagenah Ex. 2, R. 6605; 1333-1367; 1368-1370; 1759-1772; 2075-2090.)

No one denied that the property had a going value.

In the tentative findings the Commission found that it had. In the final findings, although conceding that the

property had a going value, the Commission merely concluded:

> "We therefore now hold that the amount, tentatively allowed by the Commission, of $3,592,040.00 as going concern value should be eliminated as a separate item." (R. 173.)

But the issue cannot be avoided by the mere statement that the going value should be eliminated "as a separate item." That implies that elsewhere in the final value the going value has been allowed for. The facts refute the implication.

(3) Western Electric Price Increase.

Except for an increase of approximately 10% effective November 1, 1930, the Commission approved as fair the prices paid by appellant to Western Electric Company for telephone apparatus throughout the period. (R. 165; 169.) The Commission also found that Western's profits in its Bell system business were reasonable. (R. 165; 168.)

The prices approved included the following substantial price reductions: 1925, 1.1%; 1926, 8.7%; 1927, 4.9%; 1928, 10.3%; and 1929, 8.6%. (Ex. X-13A, R. 8966; 3488.)

What weighting was given to Western's prices in the trended values of appellant's property is not disclosed in the order. The Commission refused to permit any investigation of the subject. (R. 273; 275; 312; 373; 387; 722.) It is admitted, however, that Western's reduced prices were given some weighting and its increased prices none:

Western's reductions were made at a time when other manufacturers were maintaining or increasing their prices. (R. 3982.) A reduction made shortly prior to 1930 was based upon an expected increase in Western's Bell sales, but when in 1930 it became apparent that the expected increase would not occur, the 10% price increase effective November 1, 1930 became necessary. (R. 3982.)

Western's earnings on investment and profit on sales vary from year to year due to several factors, one of the most important of which is the capacity at which its plants are operated. These factors cause substantial variations in its annual profits. (R. 3877.)

Even with Western's increased prices effective November 1, 1930, it earned only 4.3% and 3.9% on investment in its Bell business for the years 1930 and 1931, respectively, and for the year 1932 it sustained a loss in excess of $6,400,000. (R. 4410; Ex. A-194; R. 8839A.)

Whenever Western could reduce its prices to appellant it did so, and as long as the reductions continued, the Commission found the prices to be fair. When, however, Western made a necessary increase in prices, the Commission rejected the increase as unfair.

(4) Failure To Give Fair Consideration To Cost Or Reproduction Cost.

The Commission fixed the tentative value of appellant's property as of June 30, 1925, the date certain, at $104,282,735, of which $101,346,634 represented the value of the intrastate portion on the basis of the separation later adopted by the Commission. (R. 147; 243.)

The final value of the intrastate property as of June 30, 1925, was fixed at $93,707,488, a reduction of $7,639,146 from the tentative finding.* (R. 196; 247.)

The final value gave no consideration to reproduction cost new.

In 1925 telephone costs in Ohio had reached a new level *from 55% to 60% above that of 1913, most of the increases having taken place in 1916 and thereafter.* (R. 2117.) The evidence showed that the new level probably would continue for several years, as it in fact did. (R. 2117.) Although it

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* The details of this reduction are shown at page 7, *supra*.

is impossible to evaluate the total appreciation in appellant's property due to this change in price level, the following facts show that the reproduction cost of appellant's property in 1925 greatly exceeded its recorded book cost.

The average cost of plant per telephone in Ohio increased from $173 in 1921 to $200.51 at the close of 1925, an increase of $27.51 per station. (Commission's witness Hagenah, R. 2116.)

Only four witnesses testified to the cost to reproduce the entire property. They were Sloan, Williams and Schneider for appellant and Hagenah for the Commission.* In the main the differences between appellant's witnesses and Hagenah arose out of the fact that in arriving at their respective labor costs appellant's witnesses used its costs experienced in recent large construction projects, whereas Hagenah used theoretical costs, lower than appellant's, on the ground that there would be savings in a wholesale reproduction program. (R. 2064; 2069.) On that account, and almost solely on that account, Hagenah's reproduction cost was lower than that of appellant's witnesses by more than $12,000,000. (R. 2066.) Even his estimate of the reproduction cost new, less depreciation and going value, was approximately $5,000,000 above the Commission's final finding of $93,707,488. (R. 231; 2095; 2088.) It is submitted that in view of the increase in reproduction cost over book cost in 1925, shown above, Hagenah's estimate of value was the minimum which the Commission was entitled to adopt. In any event, the Commission was not justified in finding a value which was $5,000,000 less than his estimate for that year.

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* Another witness, Allensworth, submitted a partial appraisal. The Commission adopted none of his costs, presumably because he was unacquainted with telephone values in Ohio during the period in controversy. (R. 2693; 2823; 2805.)

Appellant's Valuation Offer.

Although the evidence showed the substantial increase in price levels occurring since the installation of the major portion of appellant's plant, appellant did not seek a finding of value reflecting all of that increase. On April 15, 1930, before the Commission had fixed the tentative or final values, appellant offered to accept, as fair value, its property cost undepreciated, including construction work in progress and cash working capital. (R. 139.) If this offer had been accepted, appellant's intrastate property would have been valued at approximately $101,000,000, compared with the Commission's tentative value of $101,346,634, and as against the final value of $93,707,488. (R. 147; 243; 231.)

Such a value, although substantially below the reproduction cost new less depreciation of the property, would have given appellant the benefit of some portion of the increase in value due to the permanent change in price levels testified to by the Commission's engineer.

In conclusion on the question of value, the following table (see page 15, *supra*) shows how the Commission disregarded the cost of the property in arriving at values for the years under investigation:

	Commission's Value Including Allowance for Working Capital and Supplies	Average Cost Plus Commission's Allowance for Working Capital and Supplies
1925	$ 93,707,488	$ 98,798,259
1926	101,767,774	107,424,541
1927	111,036,522	118,526,298
1928	122,417,735	131,597,552
1929	134,765,576	143,380,043
1930	145,683,047	156,319,161
1931	145,271,663	163,153,973
1932	133,625,655	163,723,323
1933	126,250,206	162,403,661

For the errors pointed out appellant urges that the judgment of the Supreme Court of Ohio be reversed and that Court directed to reverse the orders of the Commission.

Respectfully submitted,

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March 6, 1937.

APPENDIX.

Pence Law, p. i

§ 614-23 of the General Code, p. iv

Commission's Detailed Valuation of June 30, 1925, p. vii

Commission's Application of Trends, p. ix

License Contract Costs Allowed and Disallowed, p. xi

Commission's Order of September 6, 1934, p. xix

Valuation Sections, Ohio General Code, p. xxix

Pence Law.

The Pence Law, Section 614-20, passed April 4, 1923, 110 Ohio Laws, 366, which amended the Robinson Law, is as follows:

> "Unless otherwise ordered by the commission, no change shall be made in any rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, or as shown upon the schedules which shall have been filed by a public utility in compliance with the requirements of this act, or by order of the commission, except after thirty days' notice, in writing, to the commission, which notice shall plainly state the changes proposed to be made in the schedule then in force, and the time when the change, rate, charge, toll, classification, or rental shall go into effect; and all proposed changes shall be plainly indicated upon existing schedules, or by filing new schedules thirty days prior to the time when they are to take effect, but the commission may prescribe a less time when they may take effect, provided, however, that if the proposed change shall effect an increase in the rate, joint rate, toll, classification, charge or rental, notice, in form approved by the commission, published once each week for three consecutive weeks before the effective date thereof, unless the commission shall authorize a less time, shall be given by publication in a newspaper published at the county seat of each county in which such change applies, and of general circulation therein, or in one newspaper published in, and of general circulation throughout the territory in which such utility operates.

Such published notice shall set forth the fact that such application has been made, the effective date of the proposed new schedule, the name and location of the agent of the utility in such county or territory where a copy of such proposed new schedule may be inspected by any interested party; and provided, further, however, that such utility shall at the time of the filing of the schedule with the commission, place on file with such agent of such utility a copy of the proposed new schedule and keep the same on file for the inspection of any interested party pending the hearing before such commission.

Whenever there shall be filed with the commission any schedule effecting an increase in any rate, joint rate, toll, classification, charge or rental, or stating any new regulation or practice affecting any existing rate, joint rate, toll, classification, charge or rental in force at the time this act takes effect, the commission shall have, and it is hereby given authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other form of pleading by the interested public utility, but upon reasonable notice, to enter upon a hearing concerning the propriety of such rate, joint rate, toll, classification, charge, rental, regulation or practice; and pending such hearing and the decision thereon, the commission upon filing with such schedule and delivering to the public utility affected thereby, a statement in writing of its reasons for such suspension, shall suspend the operation of such schedule and postpone the use and operation of such rate, joint rate, toll, classification, charge, rental, regulation or practice, but not for a longer period than one hundred and twenty days from the time when such schedule was filed with the commission; and after a full hearing, whether completed before or after the rate, joint rate, toll, classification, charge, rental, regulation or practice goes into effect, the commission may make such order in reference to such rate, joint rate, toll, classification, charge, rental, regulation or practice as would be proper in a proceeding initiated after the rate, joint rate, toll, classifica-

tion, charge, rental, regulation or practice had become effective; provided, that if any such hearing cannot be concluded within the period of suspension, as above stated, such rate, joint rate, toll, classification, charge, rental, regulation or practice shall go into effect at the end of such period of suspension upon the public utility filing with the commission a bond, undertaking or other security, to the satisfaction of the commission, securing and guaranteeing the repayment, with interest at the rate of six per centum per annum from the date of payment by the consumer to the date of repayment by the utility, to all the consumers of such portion of such increased rate, joint rate, toll, classification, charge or rental, collected by such utility as the commission, upon final hearing, may determine to have been unreasonable or excessive, which repayments shall be made at such times and in such amounts as the commission shall order, and shall be promptly paid by said utility to the corporations or persons entitled thereto, and in such manner as the commission may prescribe, and if any such money ordered by the commission to be repaid shall not have been claimed by the corporations or persons entitled thereto, within one year from the time the same shall become due and payable in accordance with the order of the commission, all such moneys shall be paid by the utility to the treasurer of the county, or other political subdivision, in which such new schedule is effective for the benefit of its general fund, in such amounts and in such manner as the commission may order; and thereafter such public utility shall not be liable therefor. Such bond, undertaking or security shall be in such amount as the commission may from time to time determine; provided, however, that the amount fixed at any time shall not, in addition to the amount of such increase or other charge made by the utility already accrued, exceed the estimated amount of such increase or other charge made by the utility extending over a period of one year, based upon the business of the utility for the previous year, or be less than one-half of such estimated amount.

All rates, joint rates, tolls, classifications, charges or rentals of a public utility heretofore or hereafter fixed and determined by any order of the commission under the provisions of this chapter shall be in force and be prima facie lawful for two years from their effective date or until changed or modified as provided by law; provided, however, that after any such rate, joint rate, toll, classification, charge or rental shall have been in force for a period of two years, the same may be changed by the public utility affected in the manner provided in this section; and that nothing herein contained shall be construed as in any way affecting the right of any person or public utility to make application, as provided in sections 614-21 and 614-23 of the General Code or otherwise as provided by law, for an order rescinding, altering or amending any order of the commission within said two year period or thereafter.

At any hearing involving a rate increased or sought to be increased after this section shall have become effective, the burden of proof to show that the increased rate or the proposed increased rate is just and reasonable shall be upon the public utility and the commission shall give to the hearing and decision of such question, preference over other questions pending before it, and decide the same as speedily as possible."

Section 614-23 of the General Code of Ohio.

Section 614-23, which confers upon the Commission authority to fix rates, and which limits that authority to rates for the future, is as follows:

"Whenever the commission shall be of the opinion, after hearing, that any rate, fare, charge, toll, rental, schedule, classification or service, or any joint rate, fare, charge, toll, rental, schedule, classification, or service rendered, charged, demanded, exacted or proposed to be rendered, charged, demanded, or exacted is, or will be, unjust, unreasonable, unjustly discriminatory or unjustly preferential or in violation

of law, or the service inadequate, or that the maximum rates, charges, tolls, or rentals chargeable by any such public utility are insufficient to yield reasonable compensation for the service rendered, and are unjust and unreasonable, the commission shall, with due regard among other things, to the value of all of the property of the public utility actually used and useful for the convenience of the public, excluding therefrom the value of any franchise or right to own, operate or enjoy the same in excess of the amount (exclusive of any tax or annual charge) actually paid to any political subdivision of the state or county, as the consideration for the grant of such franchise or right; and exclusive of any value added thereto by reason of a monopoly or merger and to the necessity of making reservation out of the income for surplus, depreciation and contingencies, and all such other matters as may be proper, according to the facts in each case, fix and determine the just and reasonable rate, fare, charge, toll, rental or service to be thereafter rendered, charged, demanded, exacted or collected for the performance or rendition of the service, and order the same substituted therefor; and thereafter, no change in the rate, fare, toll, charge, rental, schedule, classification or service, shall be made, rendered, charged, demanded, exacted or changed by such public utility without the order of the commission and any other rate, fare, toll, charge, rental, classification or service shall be deemed and held to be unjust and unreasonable, prohibited and unlawful. Upon application of any person or any public utility, and after notice to the parties in interest and opportunity to be heard as provided in this act for other hearings, has been given, the commission may rescind, alter or amend an order fixing any rate or rates, fare, toll, charge, rental, classification or service, or any other order made by the commission. Certified copies of such orders shall be served and take effect as provided for original orders."

Commission's Detailed Finding of Value for 1925

APPENDIX A OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307

SUMMARY OF FINAL VALUATION AS OF JUNE 30, 1925

Line No.	Acct. No.	Description	Reproduction Value	Percent Condition	Present Value
1.	207	Right of way	$1,243,034	100.00	$1,243,034
2.	211	Land	3,256,854	100.00	3,256,854
3.	212	Buildings	7,788,774	90.18	7,023,924
4.		Total Land and Buildings	$11,045,628	Ave. 93.08	$10,280,778
5.	221	Central Office Telephone Equipment	17,199,740	85.75	14,748,777
6.	222	Other Equipment of Central Offices	634,689	84.72	537,709
7.		Total Central Office Equipment	$17,834,429	Ave. 85.71	$15,286,486
8.	231	Station Apparatus	5,759,956	85.68	4,935,086
9.	232	Station Installations	2,034,423	80.00	1,627,538
10.	233	Interior Block Wires	83,881	80.00	67,105
11.	234	Private Branch Exchanges	3,384,995	85.75	2,902,633
12.	235	Booths and Special Fittings	167,201	80.00	133,761
13.		Total Station Equipment	$11,430,456	Ave. 84.56	$9,666,123
14.	241	Exchange Pole Lines	9,412,432	72.93	6,864,844
15.	242	Exchange Aerial Cable	8,055,194	87.71	7,064,968
16.	243	Exchange Aerial Wire	4,556,220	76.72	3,495,338
17.	244	Exchange Underground Conduit	9,386,032	95.00	8,916,730
18.	245	Exchange Underground Cable	9,810,730	91.85	9,011,082
19.	246	Exchange Submarine Cable	19,730	95.00	18,744
20.		Total Exchange Lines	$41,240,338	Ave. 85.77	$35,371,706
21.	251	Toll Pole Lines	6,108,489	80.93	4,943,325
22.	252	Toll Aerial Cable	536,254	91.50	490,692
23.	253	Toll Aerial Wire	3,842,664	91.78	3,526,696
24.	254	Toll Underground Conduit	30,493	95.00	28,968
25.	255	Toll Underground Cable	421,257	91.64	386,032
26.	256	Toll Submarine Cable	12,652	95.00	12,019
27.		Total Toll Lines	$10,951,809	Ave. 85.72	$9,387,732
28.	261	Office Furniture and Fixtures	624,244	85.00	530,607
29.	263	General Store Equipment	18,181	85.00	15,454
30.	264	General Stable and Garage Equipment	652,331	75.00	489,248
31.	265	General Tools and Implements	422,051	70.00	295,436
32.		Total General Equipment	$1,716,807	Ave. 77.51	$1,330,745
33.		Total Physical Property	$95,462,501	Ave. 86.49	$82,566,604
		Undistributed Construction Expenditures:			
34.		Omissions 1%	814,570	Ave 85.58	697,120
35.		Interest During Construction..... 6%	5,727,750	" 86.49	4,953,996
36.		Engineering 5%	3,243,948	" 85.67	2,779,056
37.		Taxes During Construction..... 1%	954,625	" 86.49	825,666
38.		General Expenses 2%	1,909,250	" 86.49	1,651,332
39.		Total Undistributed Construction Expenditures	$12,650,143	Ave. 86.22	$10,907,170
40.		Total Fixed Capital	$108,112,644	Ave. 86.46	$93,473,774
41.		Working Capital Including Materials & Supplies	2,948,502	100.00	2,948,502
42.		Total Property Used and Useful	$111,061,146	Ave. 86.82	$96,422,276
		Less,—			
43.		Interstate Proportion of Total.....2.81552%	3,126,949	" 86.82	2,714,788
44.		Intrastate Property Used and Useful...97.18448%	$107,934,197	Ave. 86.82	$93,707,488

Commission's Application of Trends

APPENDIX B OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307

VALUATION OF PROPERTY USED AND USEFUL FOR EACH YEAR FROM 1925 TO 1933, BOTH INCLUSIVE AND TRENDS OF SUCH VALUATION.

	June 30, 1925	Last 6 Mos. 1925	Year 1926	Year 1927	Year 1928	Year 1929	Year 1930	Year 1931	Year 1932	11 Mos. 1933
Fixed Capital										
All Items Except Right of Way and Restored Land Values—										
1. Final Valuation Fixed by Commission	$92,118,867									
2. Trended Value First of Period—Percent of Line 6	.....	100.00% A	98.73% B	96.97% C	99.20% D	101.45% E	95.65% F	93.95% G	88.71% H	102.96% I
3. Trended Value First of Period—Amount	.....	$92,118,867	$96,311,536	$100,642,148	$116,752,169	$129,566,975	$137,815,645	$142,265,570	$129,465,177	$130,552,050
4. Net Additions During Period—Per Books at 100%	.....	5,431,559	7,475,355	17,051,571	10,962,937	14,516,292	13,547,388	3,730,462	2,666,372*	1,254,329*
5. Trended Value End of Period	92,118,867 A	97,550,426 B	103,786,891 C	117,693,719 D	127,715,106 E	144,083,267 F	151,363,033 G	145,942,032 H	126,798,806 I	129,297,721
Right of Way:										
6. Book Value plus Undistr. Constr. Exp. End of Period—at 100%	1,354,907	1,421,549	1,418,728	1,420,376	1,500,557	1,579,461	1,712,919	1,743,117	1,782,806	1,754,696
Restored Land Values:										
7. Trended Value End of Period—Per Appendix "C"	.....	2,430	36,570	484,401	521,174	685,999	644,061	606,085	536,771	556,172
8. Total Fixed Capital End of Period	$93,473,774	$98,974,405	$105,242,189	$119,598,496	$129,737,137	$146,328,727	$153,720,003	$148,290,234	$129,118,382	$131,608,588
	6-30-25		6-30-26	6-30-27	6-30-28	6-30-29	6-30-30	6-30-31	6-30-32	6-30-33
Average Fixed Capital:										
9. Based Upon Line 8, First and End of Period	93,473,774		102,106,297	112,420,342	124,667,816	138,032,992	150,024,365	151,005,118	138,704,308	130,263,485
Working Capital Including Materials and Supplies										
10. Average Per Appendix "E"	2,948,502		2,923,583	3,062,701	3,218,291	3,451,024	3,250,138	2,804,990	2,497,696	3,044,894
Total Property Used and Useful										
11. Total Lines 9 and 10	96,422,276		105,031,880	115,473,043	127,886,107	141,483,956	153,274,503	153,810,108	141,202,004	133,408,379
Less—										
12. Interstate Proportion of Total	2,714,788		3,264,086	4,438,621	5,468,372	6,718,380	7,591,456	8,538,445	7,576,349	7,158,173
13. Intrastate Property Used and Useful	$93,707,488		$101,767,774	$111,036,522	$122,417,735	$134,765,576	$145,683,047	$145,271,663	$133,625,655	$126,250,206

NOTE—The composite percentages shown on Line 2 were developed by the Commission's Engineers and represent the relation of values for each current period to the preceeding period and they have been applied to the basic figures bearing corresponding alphabetical designations.

The total property used and useful shown on Lines 11 to 13 inclusive is forwarded to the rate study on Appendix "M". Interstate and Intrastate Allocations have been made on the basis of percentages shown on Appendix "L".

Line 6 includes undistributed construction expenditures at 6-30-25 added to book figures in all columns as follows: 6% interest during construction, $74,582—Taxes during construction, $12,430—General expenses, $24,861—Total, $111,873. There is also included a book deduction covering re-classification during the 11 months of 1933 in the amount of $3,630.

*Indicates red figures.

APPENDIX G OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307

COST OF A. T. & T. COMPANY LICENSE CONTRACT SERVICES ALLOWED AS A DEDUCTION FROM REVENUES UNDER ACCT. 527—LICENSEE REVENUE—DR.—FOR EACH YEAR FROM 1925 TO 1933, BOTH INCLUSIVE

Costs Allowed	Year 1925	Year 1926	Year 1927	Year 1928	Year 1929
1. A. T. & T. Co. departmental expenses—Appenix "H"	$308,536	$332,039	$381,589	$419,986	$442,627
2. Office space and furniture expense	3,157	731	837	912	974
3. Instrument maintenance	61,291	81,311	86,754	.....	.....
4. Instrument depreciation	51,793	56,506	58,882	.....	.....
5. Return on instruments	95,300	103,970	108,343	.....	.....
6. Total costs allowed	$520,077	$574,557	$636,405	$420,898	$443,601
Payments Made					
7. Licensee Revenue—Dr.—(Acct. 527) per books.	1,274,052	1,277,944	1,402,144	752,524	626,184
Expense Allowed					
8. Line 6 or 7, whichever is lower	520,077	574,557	636,405	420,898	443,601

Costs Allowed	Year 1930	Year 1931	Year 1932	Year 1933	
9. A. T. & T. Co. departmental expenses—Appendix "H"	$532,473	$520,006	See Note .		
10. Office space and furniture expense	1,015	1,078			
11. Instrument maintenance	.....	.....			
12. Instrument depreciation	.....	.....			
13. Return on instruments	.....	.....			
14. Total costs allowed	$533,488	$521,084	$521,084	$521,084	
Payments Made					
15. Licensee Revenue—Dr.—(Acct. 527) per books.	638,043	619,171	545,057	466,923	
Expense Allowed					
16. Line 14 or 15, whichever is lower	533,488	521,084	521,084	466,923	

NOTE: As there is no evidence in the record concerning costs for 1932 and 1933, they have been estimated at the same amount as for 1931.

Payments made of Licensee Revenue—Dr.—for 1933 have been estimated on the basis of payments for the eleven months ended November 30, 1933.

The amounts on lines 8 and 16 are forwarded to Exhibit "F", lines 5 and 24.

APPENDIX H OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307

A. T. & T. COMPANY DEPARTMENTAL EXPENSES ALLOWED AND DISALLOWED AS PART OF COST OF LICENSE CONTRACT SERVICES FOR EACH YEAR FROM 1925 TO 1931, BOTH INCLUSIVE.

	Dept. No.	Proportion	Reference to Record	Year 1925	Year 1926	Year 1927	Year 1928	Year 1929	Year 1930	Year 1931
Departmental Expenses Allowed										
1. Operation and Engineering	No.	1—Entire	A-108-B	$121,300	$131,722	$141,563	$154,161	$168,039	$176,470	$164,528
2. Development and Research	No.	2—Partial	A-117-B	100,387	108,968	131,464	147,267	160,696	230,916	235,932
3. Information	No.	3—None	A-124-B							
4. Personnel	No.	4—Partial	A-150 & 151-B	14,824	17,526	28,572	30,782	34,845	35,291	33,886
5. Public Relations	No.	5—None	A-153-B							
6. Treasurer	No.	6—Partial	A-154-B	606	680	1,214	958	1,119	1,281	1,260
7. Comptroller	No.	7—Partial	A-155-B	22,752	24,620	26,088	27,202	29,315	30,626	30,505
8. Secretary	No.	8—None	A-156-B							
9. Administrative Including Sundry	No.	9—One-half	A-157-B	14,361	14,106	16,336	14,586	15,558	14,384	12,923
10. General Service Bureau	No.	10—One-half	A-158-B	7,023	8,063	8,277	8,890	9,833	10,443	9,535
11. Operation—General	No.	11—None	A-159-B							
12. Legal	No.	12—Entire	A-160-B	27,283	26,354	28,075	36,140	23,222	33,062	31,437
13. Total Allowed			A-170-B, Line A	$308,536	$332,039	$381,589	$419,986	$442,627	$532,473	$520,006
Departmental Expenses Disallowed										
14. Operation and Engineering	No.	1—None	A-108-B							
15. Development and Research	No.	2—Partial	A-117-B	39,613	56,032	75,536	69,733	109,304	149,084	102,068
16. Information	No.	3—Entire	A-124-B	31,184	35,103	31,514	41,441	55,377	54,324	52,365
17. Personnel	No.	4—Partial	A-150 & 151-B	9,120	9,853	7,776	6,196	6,778	6,845	5,674
18. Public Relations	No.	5—Entire	A-153-B	1,129	1,086	1,086	1,120	1,444	1,932	1,483
19. Treasurer	No.	6—Partial	A-154-B	35,525	50,871	39,768	61,266	59,818	91,774	58,949
20. Comptroller	No.	7—Partial	A-155-B	22,721	24,647	26,936	29,436	31,332	33,508	31,810
21. Secretary	No.	8—Entire	A-156-B	2,389	2,453	2,348	2,571	2,639	2,527	2,038
22. Administrative Including Sundry	No.	9—One-half	A-157-B	14,361	14,106	16,335	14,585	15,559	14,385	12,922
23. General Service Bureau	No.	10—One-half	A-158-B	7,023	8,063	8,278	8,890	9,832	10,443	9,535
24. Operation—General	No.	11—Entire	A-159-B	8,694	9,682	9,349	10,113	10,857	11,147	10,071
25. Legal	No.	12—None	A-160-B							
26. Total Disallowed			A-170-B, Line A	$171,759	$211,896	$218,926	$245,351	$302,940	$375,969	$286,915
Total Departmental Expenses										
27. As Shown on Appendix "J", Line 26				$480,295	$543,935	$600,515	$665,337	$745,567	$908,442	$806,921
NOTE—The amounts on line 13 are forwarded to Appendix "G", lines 1 & 9. The partial amounts allowed on line 7 cover the following items:										
Comptroller—Dept. No. 7—										
Bell System Methods			A-155-B	$9,473	$10,437	$11,215	$11,412	$12,381	$13,022	$12,595
Chief Traveling Auditor			A-155-B	7,397	7,492	7,688	8,355	8,735	8,928	9,283
Chief Accountant			A-155-B	1,341	1,451	1,681	1,669	2,097	2,214	2,107
Proportion of Undistributed			A-155-B	3,735	4,476	4,623	4,778	5,162	5,511	5,509
Proportion of Administration			A-155-B	806	764	881	988	940	951	1,011
Total Allowed—Line 7				$22,752	$24,620	$26,088	$27,202	$29,315	$30,626	$30,505

The partial amounts disallowed on lines 15, 17, 19 and 20 are detailed on Appendix "I".

APPENDIX I OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307.

DETAILS OF PARTIAL AMOUNTS OF A. T. & T. COMPANY DEPARTMENTAL EXPENSES DISALLOWED FOR EACH YEAR FROM 1925 TO 1931, BOTH INCLUSIVE.

	Reference To Record	Year 1925	Year 1926	Year 1927	Year 1928	Year 1929	Year 1930	Year 1931
Development and Research—Dept. No. 2								
Picture Transmission	A-118-B	.....	$5,989	$5,911	$4,188	$3,458	$4,321	$7,408
Television	A-118-B	.....	1,324	10,067	3,339	5,519	3,717	3,270
Radio and Subm. Cable Tele. Conn. Eq. & Cets.	A-118-B	.....	.....	.....	.....	.....	11,961	11,339
Radio Transmission Systems	A-118-B	30,397	35,252	43,571	44,529	66,611	83,203	46,424
Vacuum Tubes	A-118-B	9,216	12,389	11,469	12,812	11,206	14,333	14,903
Photo Electric Cells	A-118-B	.....	1,078	620	1,222	1,415	1,251	2,920
Submarine Cable	A-118-B	.....	.....	3,898	3,613	21,095	27,298	15,804
Total Disallowed—Appendix "H" Line 15		$39,613	$56,032	$75,536	$69,733	$109,304	$149,084	$102,068
Personnel—Dept. No. 4								
Special Training	A-150-B	2,716	2,934	2,393	2,605	2,888	2,885	2,276
"Other" Items Shown in Col. 4	A-150-B	1,419	1,619	1,504	1,591	1,740	1,652	1,224
Public Relations	A-150-B	599	611	610	636	703	683	638
"Other" Items Shown in Col. 4	A-151-B	748	1,071	1,206	1,364	1,447	1,625	1,536
Interest on Empl. Benefit Fund	Heiss No. 10 Supl.	3,608	3,618	2,063	.....	.....	.....	.....
Total Disallowed—Appendix "H" Line 17		$9,120	$9,853	$7,776	$6,196	$6,778	$6,845	$5,674
Treasurer—Dept. No. 6								
Direct Distribution of Securities	III. N. R. 861	2,133	16,587	2,993	22,201	15,478	36,456	5,033
Servicing Securities	III. N. R. 864	28,868	29,489	29,671	31,548	36,976	41,903	40,169
Handling Funds and Making Advances	III. N. R. 863	2,483	2,506	3,133	3,285	3,617	4,111	4,274
Financing General Department	III. N. R. 862	1,616	1,631	2,039	2,137	2,354	2,675	2,782
Handling Employees' Stock Plan	III. N. R. 862	425	658	1,932	2,095	1,393	6,629	6,691
Total Disallowed—Appendix "H" Line 19		$35,525	$50,871	$39,768	$61,266	$59,818	$91,774	$58,949
Comptroller—Dept. No. 7								
General Books and Records	A-155-B	4,942	5,367	5,957	6,432	7,100	7,926	7,850
Chief Statistician	A-155-B	10,205	11,032	12,207	13,455	14,353	15,090	14,242
Bell System Reports	A-155-B	3,033	3,001	3,088	3,311	3,358	3,421	2,918
Proportion of Undistributed	A-155-B	3,735	4,481	4,774	5,169	5,516	6,031	5,745
Proportion of Administration	A-155-B	806	766	910	1,069	1,005	1,040	1,055
Total Disallowed—Appendix "H" Line 20		$22,721	$24,647	$26,936	$29,436	$31,332	$33,508	$31,810

APPENDIX J OF COMMISSION'S FINDINGS OF JAN. 16, 1934.

THE OHIO BELL TELEPHONE COMPANY—FORMAL CASE NO. 3307

TOTAL A. T. & T. COMPANY DEPARTMENTAL EXPENSES AND FAIR PROPORTION THEREOF ALLOCABLE TO THE OHIO BELL TELEPHONE COMPANY AS SHOWN ON PAGE 223 OF COMPANY'S BRIEF FOR EACH YEAR FROM 1925 TO 1931, BOTH INCLUSIVE, AS CLAIMED BY COMPANY

	Dept. No.	Reference to Record	Year 1925	Year 1926	Year 1927	Year 1928	Year 1929	Year 1930	Year 1931
Total Departmental Expenses		A-103 & 170-B	$2,963,159	$3,301,306	$3,562,940	$3,813,983	$4,102,105	$4,340,568	$4,234,967
1. Operation ond Engineering	No. 1	A-117-B	3,402,573	4,130,418	5,182,815	5,289,081	6,738,114	9,260,867	8,655,309
2. Development and Research	No. 2	A-124-B	738,027	854,747	786,989	1,031,629	1,344,765	1,349,439	1,305,138
3. Information	No. 3	A-150 & 151-B	605,523	707,960	938,415	924,418	1,056,306	1,100,273	1,080,695
4. Personnel	No. 4	A-153-B	26,232	25,860	25,850	26,038	32,987	45,405	35,317
5. Public Relations	No. 5	A-154-B	888,219	1,298,847	1,036,942	1,549,332	1,495,599	2,349,694	1,553,145
6. Treasurer	No. 6	A-155-B	1,117,884	1,241,284	1,341,620	1,410,248	1,488,481	1,619,429	1,607,471
7. Comptroller	No. 7	A-156-B	59,725	62,817	60,452	65,040	65,881	64,965	53,526
8. Secretary	No. 8	A-157-B	706,094	710,799	826,665	726,324	763,731	726,445	666,682
9. Administrative, incl. Sundry	No. 9	A-158-B	345,309	406,307	418,879	442,702	482,643	527,394	491,918
10. General Service Bureau	No. 10	A-159-B	211,565	240,549	233,029	254,250	268,793	277,792	273,631
11. Operation—General	No. 11	A-160-B	668,165	659,735	720,319	936,315	591,505	861,264	817,142
12. Legal	No. 12								
13. Total			$11,730,495	$13,640,629	$15,134,915	$16,469,360	$18,430,910	$22,523,535	$20,774,941
Allocable to the Ohio Bell Tel. Co.		A-108-B	$121,300	$131,722	$141,563	$154,161	$168,039	$176,470	$164,528*
14. Operation and Engineering	No. 1	A-117-B	140,000	165,000	207,000	217,000	270,000	380,000	338,000
15. Development and Research	No. 2	A-124-B	31,184	35,103	31,514	41,441	55,377	54,324	52,365
16. Information	No. 3	A-150 & 151-B	23,944	27,379	36,348	36,978	41,623	42,136	39,560
17. Personnel	No. 4	A-153-B	1,129	1,086	1,086	1,120	1,444	1,932	1,483
18. Public Relations	No. 5	A-154-B	36,131	51,551	40,982	62,224	60,937	93,055	60,209
19. Treasurer	No. 6	A-155-B	45,473	49,267	53,024	56,638	60,647	64,134	62,315
20. Comptroller	No. 7	A-156-B	2,389	2,453	2,348	2,571	2,639	2,527	2,038
21. Secretary	No. 8	A-157-B	28,422	28,212	32,671	29,171	31,117	28,769	26,845
22. Administrative, incl. Sundry	No. 9	A-158-B	14,046	16,126	16,555	17 780	19,665	20,886	19,070
23. General Service Bureau	No. 10	A-159-B	8,694	9,682	9,349	10,11n	10,857	11,147	10,071
24. Operation—General	No. 11	A-160-B	27,283	26,354	28,075	36,140	23,222	33,062	31,437
25. Legal	No. 12								
26. Total			$480,295	$543,935	$600,515	$665,337	$745,567	$908,442	$806,921*

NOTE—The portions of lines 14 to 26, inclusive, which are allowed and disallowed are shown on Appendix "H".

* $10,000.00 added to correct error in figures shown in Company's brief.

COMMISSION'S ORDER OF SEPT. 6, 1934.

This day after full hearing, due notice of the time and place of which was given to all parties in interest, this matter came on for further consideration upon the order made and entered herein as of date July fifth, 1934, the objections and protests thereto; the representations and showing made at said hearing, and the report, dated August 11, 1934, with accompanying exhibits, of Special Investigator E. W. Wood, which report and accompanying exhibits hereby are made a part of the record herein.

And the Commission, coming first to consider the application and petition of said The Ohio Bell Telephone Company asking, for the reasons and upon the grounds set forth therein, among other things, a rehearing with respect to the matters and things decided and determined by the finding and order made and entered herein upon July fifth, 1934, as aforesaid, finds that sufficient cause has not been made to appear in said application and petition for such rehearing and does hereby deny the same.

To which action of the Commission in denying its said application and petition for such rehearing, said The Ohio Bell Telephone Company then excepted, here now excepts, and its exceptions here are noted of record.

And the Commission, coming now to consider the application and request of said The Ohio Bell Telephone Company that it disclose to respondent and afford it an opportunity to examine, analyze, explain and rebut certain information, and to introduce certain evidence, with respect to the matters and things decided and determined by said finding and order dated July fifth, 1934, and the Commission having heretofore incorporated into the record herein and accorded said respondent ample opportunity to exam-

ine and consider all necessary and pertinent information requested in said application, finds that the same should be, and hereby is overruled.

To which action of the Commission in overruling its said application and request, said The Ohio Bell Telephone Company then excepted, here now excepts and its exceptions here are noted of record.

And the Commission, coming now to consider the verified return of said The Ohio Bell Telephone Company to the order to show cause contained in the Commission's findings and order of July fifth, 1934, and the prayer thereof, finds that said return and the prayer thereof should be and hereby are overruled.

To which action of the Commission in overruling said verified return and the prayer thereof, said The Ohio Bell Telephone Company then excepted, here now excepts and its exceptions here are noted of record.

And the Commission, coming now to consider the matters herein now at issue as set forth in the first paragraph of this finding and order, finds that the finding as to excess intrastate toll charges collected under bond in Advanced Utility Rate Proceeding No. 124, set forth in the finding and order of July fifth, 1934, as the sum of $510,142.00 for the year 1925 and the sum of $234,399.00 for the year 1926, should be corrected to read the respective sum of $232,282.00 for the year 1925 and the sum of $176,845.00 for the year 1926.

The Commission, therefore, further finds:

That the excess charges collected under bond as provided by law in protesting exchanges, for local exchange service, is found to be as follows:

1925	$ 1,137,195.00
1926	1,637,314.00
1927	1,823,857.00
1928	1,772,238.00
1929	1,344,624.00
1930	1,357,589.00
1931	1,519,405.00
1932	830,915.00
Total	$11,423,137.00

That the excess charges collected under bond, as provided by law, for intrastate toll services for the following years is found to be as follows:

1925	$232,282.00
1926	176,845.00
Total	$409,127.00

That excess collections in the sum of $11,423,137.00 for exchange service and $409,127.00 for excess collections of intrastate toll services are refundable and subject to repayment by the Company to the subscribers and patrons paying the same;

That said $11,423,137.00 excess collections are refundable to and subject to repayment to the subscribers and patrons of said utility of the various protesting exchanges to the extent of the amount, for each exchange and for the respective years aforesaid, as shown by the schedule hereto attached, identified as Schedule A, and made a part of this finding;

That the subscribers and patrons of said utility in said protesting exchanges paying said excess charges for local exchange service are entitled to have repayment made to them in such sum as is equal to the following percent of the increase paid by them for the respective years aforesaid:

1925	100.00000%
1926	100.00000%
1927	95.59084%
1928	88.52068%
1929	62.67606%
1930	62.12778%
1931	73.06314%
1932	46.34134%

That the excess charges from intrastate toll service for the years 1925 and 1926, aforesaid, shall be repaid to the subscribers and patrons paying the same in the ratio of the increased charges of the respondent, The Ohio Bell Telephone Company, to the total excess collections, and any such refunds apportioned to connecting companies should, by such connecting companies, be repaid to their respective patrons or, if not claimed by such patrons within one year from the date payable, paid to the public treasury as hereinafter provided;

That the repayment of excess intrastate toll service charges be made to the persons, subscribers and patrons paying the same, notwithstanding payments for said services were made by such persons and patrons to telephone companies other than The Ohio Bell Telephone Company because of the interchange of telephonic services;

That interest at the rate of 6% per annum from the date of payment by the respective subscribers and patrons of said excess charges be paid to said subscribers and patrons on the amount so refundable and to be repaid to the date of repayment by the utility;

That such repayment shall be made within ninety days herefrom, in cash and/or credit upon existing indebtedness, to the subscribers and patrons entitled

thereto and if any such money to be repaid shall not have been claimed by the subscribers or patrons entitled thereto within one year from the time the same shall become due and payable, all such unclaimed money shall be paid by said The Ohio Bell Telephone Company to the Treasurer of the County or other political subdivision in which such new schedule is effective for the benefit of its general fund, and

That all findings and orders heretofore made pertaining to excessive charges and collections insofar as the same may conflict with this finding shall be so modified as to conform to this finding.

It is, therefore,

ORDERED, That said The Ohio Bell Telephone Company be, and hereby it is notified, directed and required, within ninety days herefrom, to refund in cash and/or credit upon existing indebtedness to each of its subscribers and patrons within each of the communities enumerated in Exhibit A, appended hereto, the excess or the proportion of the excess or increase which it collected under the bonds duly given in the Advanced Utility Rate Proceedings, enumerated in said Schedule A within each of the years set forth from the year 1925 to and including the year 1932, as prescribed in said Schedule A, which hereby is made a part of this order as fully as if the same were here rewritten, and to all patrons who used intrastate toll service within the State of Ohio in the years 1925 and 1926, the total excess collections of $232,282.00 for the year 1925 and of $176,845.00 for the year 1926, in the ratio of the increased charges of The Ohio Bell Telephone Company to the total excess collections made by it under bond for all intrastate toll service rendered by The Ohio Bell Telephone Company individually and jointly with connecting companies, together with

interest thereupon at the rate of six per centum per annum from the date of payment by the respective subscribers and patrons of said excess charges to the date of such repayment;

Provided, however, that if any of such money so ordered repaid including proportions of the excess intrastate toll collections apportioned to connecting companies, shall not have been claimed by the subscribers and patrons of The Ohio Bell Telephone Company and of its connecting companies, entitled thereto within one year from the time the same shall become due and payable, in accordance with this order, all such unclaimed money shall forthwith be paid by said The Ohio Bell Telephone Company to the Treasurer of the County or other political subdivision in which said new schedule is effective, to the benefit of its general fund. It is, further,

ORDERED, That all protests and objections to the finding of July fifth, 1934, herein, inconsistent with this order be, and hereby the same are, overruled.

To which order of the Commission, the objections of said parties were then noted and here are noted of record.

And it appeared further that certain of the Advanced Utility Rate Proceedings consolidated in this proceeding involve proposed increased rates which were proffered for filing prior to the initial date for the making of refunds as prescribed herein, it is, further,

ORDERED, That said The Ohio Bell Telephone Company be, and hereby it is notified, directed and required, within sixty days herefrom, to report to this Commission the amount of increase in rates which it had collected from the date of the filing of its bond until the first day of January, 1925, in each of the exchanges involved in the said Advanced Utility Rate Proceedings, consolidated herein, which were instituted prior to January 1, 1925. It is, further,

ORDERED, That within thirty days after the completion of such refunds, said The Ohio Bell Telephone Company make verified report of same to this Commission. It is further,

ORDERED, That jurisdiction of this matter be, and hereby is, retained for the purpose of making such audit or further order herein as may be necessary and proper in the premises.

THE PUBLIC UTILITIES COMMISSION OF OHIO,

FRANK W. GEIGER,
CHARLES F. SCHAEBER,
Commissioners.

(Seal)

Dated at Columbus, Ohio,
This 6th day of September, 1934.

A true copy:

C. H. KNISLEY,
Secretary.

SCHEDULE A.

THE OHIO BELL TELEPHONE COMPANY

FORMAL CASE NO. 3307

PROPORTION OF AMOUNTS COLLECTED UNDER EXCHANGE SERVICE BONDS, AS REPORTED BY COMPANY, WHICH REPRESENT EXCESSIVE RETURN ON EXCHANGE SERVICE AS FOUND BY COMMISSION.

Exchange	Effective Date	A.U.R.P.	1925	1926	1927	1928	1929	1930	1931	1932	Total
Akron,	8-1-24	138	142,887.	148,320.	152,486.	154,832.	122,856.	124,652.	138,562.	76,958.	1,061,553.
Alton,	1-1-25	160	341.	357.	372.	348.	271.	330.	425.	296.	2,740.
Bridgeport,	9-1-25	197									
Bellaire,	9-1-25	196	10,496.	30,850.	29,653.	26,767.	19,435.	19,693.	21,738.	11,552.	170,184.
Martins Ferry,	9-1-25	199									
Canfield,	11-1-25	205	455.	2,666.	2,548.	2,383.	1,679.	1,639.	1,875.	1,074.	14,319.
Canton,	2-1-27	252	—	—	75,171.	77,371.	59,221.	59,498.	64,594.	33,093.	368,948.
Cleveland,	8-1-24	142	86,717.	92,976.	94,788.	91,036.	71,411.	73,539.	84,378.	50,287.	645,132.
Columbus,	3-1-26	214	—	374,673.	445,663.	426,841.	314,927.	311,957.	354,116.	198,739.	2,426,916.
Coshocton,	10-1-26	237	—	2,229.	8,488.	7,845.	5,652.	5,531.	6,345.	3,686.	39,776.
Dayton,	8-1-24	141	268,119.	280,943.	293,214.	294,061.	227,274.	235,440.	268,639.	150,456.	2,018,126.
Dublin,	1-1-25	164	943.	947.	950.	919.	715.	754.	897.	568.	6,693.
East Palestine,	1-1-25	157	3,551.	3,542.	3,475.	3,325.	2,365	2,338.	2,656.	1,539.	22,791.
Gahanna,	1-1-25	161	1,280.	1,168	1,102.	1,011.	792.	875.	1,025.	618.	7,871.
Galloway,	1-1-25	165	787.	7[illegible]	697.	657.	459.	454.	482.	322.	4,580.
Girard,	10-1-24	149	1,917.	2,020.	1,997.	1,926.	1,396	1,387.	1,484.	779.	12,906.
Groveport,	1-1-25	170	2,012.	1,798.	1,733	1,626.	1,195.	1,240.	1,355.	835.	11,794.
Harrisburg,	1-1-25	166	1,690	1,627.	1,513	1,358.	992.	969.	1,084.	637.	9,870.
Hilliards,	1-1-25	167	1,072.	1,073.	1,052.	945.	815.	910.	1,070.	584.	7,521.
Kent,	9-1-25	198	4,753.	14,724.	14,348.	13,912	10,328.	10,557.	12,039.	7,006.	87,667.
Lancaster,	12-1-20	40	13,626.	14,115.	13,843.	13,008.	9,220	9,117.	10,561.	6,368.	89,858.
Lockbourne,	1-1-25	168	721.	627.	552.	489	258.	221.	217.	125.	3,210.
London,	10-1-26	238	—	493.	1,888.	1,704.	1,165.	1,067.	1,206.	713.	8,236.
Marietta,	8-1-24	136	19,753.	19,946.	18,678.	16,987	12,133	12,304.	13,311.	7,696.	120,808.
Massillon,	8-1-24	132	39,540.	41,322.	41,769.	39,611.	29,696.	29,124.	31,297.	16,852.	269,211.
Mentor,	10-1-26	240	—	162.	649.	593.	419.	435.	602.	375.	3,235.
Middletown,	8-1-24	137	43,933.	45,694.	45,272.	43,361	32,479.	32,996.	36,996.	21,147.	301,878.
New Albany,	1-1-25	163	1,013.	981.	925.	834.	610.	628.	736.	400.	6,127.
Niles,	10-1-24	147	6,119.	6,000.	5,523.	5,320.	3,996.	3,989.	4,143.	2,131.	37,221.
Osborn,	10-1-25	204	123.	492.	470.	435.	308.	306.	359.	228.	2,721.
Pickerington,	1-1-25	171	879.	853.	828.	813.	600.	462.	553.	340.	5,328.
Piqua,	9-1-24	143	12,110.	12,111.	11,588.	10,898	7,907.	7,774.	8,791.	4,992.	76,171.
Reynoldsburg,	1-1-25	169	1,678.	1,644.	1,639.	1,583.	1,228.	1,298.	1,476.	890.	11,436.
Ripley,	1-1-21	42	888.	915.	871.	825.	585.	559.	640.	393.	5,676.
Sedalia,	10-1-26	241	—	32.	125.	111.	77.	75.	82.	43.	545.
South Charleston,	1-1-25	159	934.	935.	909.	817.	589.	544.	601.	351.	5,680.
South Solon,	1-1-25	172	220.	199.	186.	153.	88.	85.	99.	58.	1,088.
Springfield,	4-1-26.	218	—	39,723.	51,138.	47,835	36,534.	36,713.	40,337.	21,564.	273,844.
Steubenville & Mingo Junction	9-1-24	146	22,014.	22,963.	22,558.	21,553.	16,007	15,984.	17,591.	9,280.	147,950.
Toledo,	8-1-24	139	261,624.	270,064.	269,534.	258,054.	193,480.	192,064.	209,111.	106,839.	1,760,770.
Toronto,	12-1-24	156	2,182.	2,297.	2,362.	2,355.	1,715.	1,743	1,930.	896.	15,480.
Washington Court House,	10-1-26	242	—	2,040.	7,758.	7,258.	5,034.	4,878.	5,432.	3,040.	35,440.
Worthington,	1-1-25	162	5,307.	5,184.	5,209.	5,305.	4,018.	4,347.	5,204.	3,231.	37,805.
Youngstown,	6-1-24	135	177,511.	187,887	190,333	185,173.	144,695.	149,113.	165,366.	83,954.	1,284,032.
Total,			1,137,195.	1,637,314.	1,823,857.	1,772,238.	1,344,624.	1,357,589.	1,519,405.	830,915.	11,423,137.
Refundable Proportion of Increase Collected			100.00000%	100.00000%	95.59084%	88.52068%	62.67606%	62.12778%	73.06314%	46.34134%	

VALUATION SECTIONS, OHIO GENERAL CODE.

Section 499-8.

The commission, for the purpose of ascertaining the reasonableness and justice of rates and charges for the service rendered by public utilities or railroads of this state, or for any other purpose authorized by law may investigate and ascertain the value of the property of any public utility or railroad in this state, used or useful for the service and convenience of the public. At the request of the council of any municipality the commission after hearing and determining that such a valuation is necessary may also investigate and ascertain the value of the property of any public utility used and useful for the service and convenience of the public where the whole or major portion of such utility is situated in such municipality. Every public utility or railroad shall furnish to the commission, its engineers, experts or other assistants from time to time and as the commission may require maps, profiles, contracts, reports of engineers and other documents, records and papers or copies of any or all of the same, in aid of any investigation and ascertainment of the value of its property, and shall grant to the commission or its agents free access to all of its premises and property and its accounts, records and memoranda whenever and wherever requested by any such duly authorized agent, and every public utility or railroad is hereby directed and required to cooperate with and aid the commission in the work of the valuation of its property in such further particulars and to such extent as the commission may require and direct. The commission shall have such power to make all rules and regulations, as to it may seem necessary, to ascertain the value of each and every utility or railroad in the state.

Section 499-9.

The commission shall prescribe the details of the inventory of the property of each public utility or railroad in the state; and such inventory shall include all the kinds and classes of property, with the value of each, owned by each public utility or railroad, used and useful for the service and convenience of the public. In ascertaining the value of the various kinds and classes of property of each public utility or railroad, the commission shall have authority to ascertain and report in such detail as it may deem necessary as to each piece of property owned or used by such public utility or railroad to show separately the following facts:

A. The original cost, if any, of each parcel of land owned and used by such public utility or railroad, and a statement of the conditions of acquisition; whether by direct purchase, by donation, by exercise of the power of eminent domain or otherwise.

B. The value as of a date certain, of each parcel of land owned and used by such public utility or railroad, by comparison with the value of contiguous and neighboring parcels of land, and land of similar character as to location and use.

C. If there shall be any additional value to such utility or railroad by reason of the ownership by it of one or more parcels of land and its use as a continuous right of way for transportation purposes, or for other purpose, such additional value shall be separately and specifically set forth for each parcel.

D. The cost of new production as of a date certain, of all physical property other than land, owned and used by such public utility or railroad, showing the values of the separate items comprising such property, together with the unit basis of such valuation.

E. Depreciation, if any, from the new reproductive cost as of a date certain, for existing mechanical deterioration, for age, for obsolescence, for lack of utility or for any other cause, the percentage and amount of each class of depreciation, if any, to be specifically set forth in detail.

F. The net value as of a date certain, of all physical property other than land owned by such utility or railroad, to be derived by deducting the sum of the amounts of depreciation from the sum of the new reproductive costs.

G. If there shall be any additional value given to the value of the property of a public utility or railroad due to the possession of a franchise to perform a public service, or for good will or for financing, such additional value shall be separately and specifically set forth, together with the basis for the computation or estimate of such additional value.

H. A duplicate copy of the record of every physical valuation of a public utility or railroad shall be furnished to the Ohio tax commission, on request, for its use in ascertaining the value of the property of such utility or railroad for purposes of taxation, and upon demand any person or corporation owning or operating a public utility or railroad shall be furnished with a copy of the valuation of his or its property.

Such investigations and report shall show separately the property used and useful to such utility or railroad in the furnishing of the service to the public, and the property held by such utility or railroad for other purposes, and such other items concerning values and methods of making valuations as the commission may deem proper; which said inventories and reports shall be filed in the office of the commission for the information of the governor and the general assembly.

Section 499-10.

Such investigation and report shall also show whenever the commission may deem necessary, the amounts and dates and rates of interest of all bonds, outstanding against each public utility or railroad, the property upon which they are a lien, the amounts paid therefor; and, in such detail as may be necessary, the original capital stock and the moneys received by any such utility or railroad by reason of any issue of stock, bonds or other securities. Such report shall also show the net and gross receipts of such utility or railroad and the method by which moneys were expended or paid out and the purpose of such payments. The commission shall have the power to prescribe the method of procedure to be followed in making the investigation and valuation and the form in which the results of the ascertainment of the value of each utility or railroad shall be submitted, and the classifications of the elements that constitute the ascertained value. Such investigation shall also show the value of the property of every public utility or railroad as a whole; and, in case such utility or railroad has property in more than one county, the value of its property in each of such counties.

Section 499-11.

The Commission during the making of the valuation herein provided for, and after the completion thereof, shall thereafter in like manner keep itself informed through its engineers, experts and other assistants of all extensions and improvements or other changes in the condition and value of the property of all public utilities or railroads and shall ascertain the value of such extensions, improvements and changes and shall from time to time, as may be required for the proper regulation of such public utilities or railroads, revise and correct its valuations of property,

showing such revisions and corrections as a whole and as to each county in the state. Such revisions and corrections shall be filed in the same manner as is provided for original reports.

Section 499-12.

The commission, whenever it shall have completed the valuation of the property of any public utility or railroad and before such valuation shall have become final, shall give notice by registered letter to such public utility or railroad, or if the whole or the major portion of said utility or railroad is situated in any municipality, then to the mayor of such municipality, stating the valuations placed upon the several kinds and classes of property of such public utility or railroad and upon the property as a whole. If within thirty days after such notification no protest shall have been filed with the commission then said valuation shall be and become final. If notice of protest shall have been filed, however, by any public utility or railroad, the commission shall fix a time for hearing the same and shall consider at such hearing any matter material thereto presented by such public utility or railroad or municipality, in support of its protest or by any representative of the public against such protest. If after the hearing of any protest of any valuation so fixed, the commission shall be of the opinion that its inventory is incomplete or inaccurate or that its valuation is incorrect it shall make such changes as may be necessary and shall issue an order making such corrected valuations final. A final valuation by the commission and all classifications made for the ascertainment of such valuations shall be public and shall be prima facie evidence relative to the value of the property.